MODESTO IRRIGATION DISTRICT | 2009 ANNUAL REPORT | WATER & POWER

reflection (ri-flek-shun) – **noun:** *The reverting of the mind to that which has already occupied it; continued consideration; meditation; contemplation; hence, also that operation or power of the mind by which it is conscious of its own acts or states; the capacity for judging rationally, especially in view of a moral rule or standard.*

To quote businessman Warren Buffett, ***"The rearview mirror is always clearer than the windshield."*** It is easy to measure and judge the activities, adversities and accomplishments of the past year. It can be difficult to predict what is to come. However, through reflections one can see that the 2009 actions of the Modesto Irrigation District are part of the groundwork for meeting the needs and challenges we can see on our industry's horizon.

Green energy is now not only a buzz word, it is well on its way to becoming a requirement in California. Much of MID's power resource planning and project development this year revolved around acquiring more green energy to meet pressing mandates.

It is difficult to determine exactly how much these green energy mandates and other mandates will affect MID electric rates. What we do know is the cost of power is poised to rise. MID estimates that the cost of California's green energy mandates will grow from $9 million currently to a projected $28 million green power premium in 2014.

One area where we are proud to see growth is MID's smart grid. Deployment of more than 100,000 smart electric meters this year optimized opportunities to empower our customers with more choices and greater energy management controls in the coming years.

Several key upgrades to MID's irrigation system improved operational efficiencies. These upgrades will make possible the next phase of enhancements, which include implementation of new water ordering and billing software. With these improvements, MID will continue to reliably deliver water to our growers.

MID is always striving to better serve our community. Being an active participant in various events, providing support to the organizations that make our community thrive and sustaining strategic partnerships with organizations with common goals reflect a steady commitment to community vitality.

Reflecting back on the year, I see the formation of a strong foundation for the future.

Allen Short

Allen Short
General Manager

Smart thinking

MID electric meters got a whole lot smarter in 2009. With deployment of more than 100,000 residential and commercial advanced digital meters, MID was poised to take the next step in enhancing our electric grid.

MID was one of only six California utilities chosen to receive a smart grid grant from the U.S. Department of Energy. The $1.5 million grant will be applied to planning and implementation of smart control equipment including automated capacitor bank controllers and voltage equipment at MID substations. This equipment, which exchanges data with smart meters at customer locations, will reduce system-wide energy use and deliver a substantial cost savings to MID customers.

Beaming Energy 411

More than 4,000 fourth- and sixth-graders are also smarter – smarter energy users; that is; thanks to MID's Energy 411 program. In partnership with the Great Valley Museum, specialized teachers visited 30 local schools to talk about electricity – how power is generated from fossil fuels, hydropower, sun, wind and other sources. Students participated in hands-on activities such as powering hand-cranked flashlights, spinning pinwheels by steam from tea kettles or by water from faucets, as well as making miniature fans run by holding a small solar panel up to the sun.

Each student received an Energy 411 kit that included three energy-saving compact fluorescent light bulbs and tools for monitoring home energy use, such as a refrigerator thermometer and a device that whistles when the air conditioner filter is clogged. With these tools plus know-how gained in the classroom, the students empower their parents to save energy and money.


MID
ENERGY 411
SHOWING KIDS HOW TO SAVE ENERGY
Start Now!
FOCUS AXR-SD
MODESTO IRRIG. DIST.
204736

Mirror, mirror on the wall

Planning, choosing and balancing a diverse and cost-effective power resource mix isn't as easy as asking the mirror on the wall which resource is the fairest of them all. MID is diligent in weighing the advantages, disadvantages, benefits and risks of each resource we bring into our power mix. MID is also not dependent on any one resource – we maintain diversity in types of resources, locations of resources, ownership and partnerships and strategically vary durations of our power contracts.

Legislative and regulatory pressures to bring our green energy portfolio up to 33 percent by 2020 in addition to significantly reducing greenhouse gas emissions drove much of MID's resource planning and development activity this year.

In September, MID executed a long-term purchase power agreement with Iberdrola Renewables to receive the output from its 99 megawatt Star Point Wind Project near Moro, Oregon. This additional wind power bolsters MID's renewable energy from 12 percent to 18 percent in the coming year.

The year also brought opportunity to explore new energy storage technology. Primus Power Corporation based in Alameda, California was awarded a $14 million U.S. Department of Energy federal stimulus grant to develop the company's modular energy storage flow battery technology. The batteries are designed to store up to 25 megawatts of energy and are expected to output maximum power for approximately three hours. MID was invited to participate in the project, host field tests of this innovative technology and provide reports to assist in evaluating the flow batteries over the next five years. Energy storage technology is key to integrating large amounts of energy from intermittent green energy resources such as wind into our electric grid.

The quick-starting generation provided by six natural gas-fired reciprocating engines at MID's Woodland 3 generation plant will also tango well with green energy resources by providing ancillary services and emergency backup power. Construction activities at the reciprocating engine generation plant progressed through the year. Scheduled for completion in 2011, the plant will provide 49.6 megawatts of peaking power necessary to maintain and deliver reliable power to MID's 111,000 customers.

As Greek fabulist Aesop once said, ***"It is thrifty to prepare today for the wants of tomorrow."*** In the electric utility industry, green energy is the want of the future. As the demand for green energy grows, costs escalate in tandem. MID estimates that the cost of California's green energy mandates will grow from $9 million currently to a projected $28 million green power premium in 2014. This is why MID strategically continued on the path of securing practical and prudent green power resources to contend with the upward pressures of legislative mandates.

WATER

One of the best places to see a reflection is in the water. Study of one's physical and mental reflections can prompt desires for improvement. MID is no different; we constantly seek and evaluate ways to improve our services, practices, infrastructure and efficiencies.

Irrigation system makeover

With the help of the Irrigation Training and Research Center, MID launched a Comprehensive Water Resources Management Plan in 2008 to assess long-term needs and opportunities for developing the best solutions for future water delivery service and the protection of MID's senior water rights. The multi-phase plan development and implementation continued through 2009.

Notable accomplishments included design and installation of a new irrigation control SCADA system which provided new water management tools and yielded more flexible, responsive operation of our canals. This modernization coupled with robust automation improvements at key locations of the MID canal system improved both the District's operational efficiency and customer service.

Looking ahead, irrigation operations upgrades in the coming year include integration of new water ordering, delivery and billing software to further enhance MID's commitment to communication, coordination and cooperation with our agricultural community.

Improving salmon fisheries

MID also maintains its commitment to improving our native fisheries. California salmon populations are quickly dwindling to counts of only a few thousand. From participation in river flow monitoring and adjustments to ecosystem studies and fishery analysis, MID dedicated time, attention and resources that examined factors of salmon fate.

Radio tracking tags on young salmon released into the Sacramento-San Joaquin River demonstrated that most end up in the stomachs of non-native predators such as striped bass. Such undisputable scientific evidence led MID to support California legislation calling for removal of striped bass fishing limits in the San Joaquin Delta to give young salmon a greater chance at survival. Though the legislation ultimately failed to move forward, MID continued discussions with legislators and regulatory agencies to champion solutions and recognize predation by non-native species as a leading threat to the declining salmon fishery.

From the looking glass to more water glasses

With a vision to consistently raise reliability and maintain the high quality of Modesto's drinking water, MID raised a glass of treated Tuolumne River surface water in toast to the near completion of the multi-year construction of Phase Two of the Modesto Regional Water Treatment Plant. Expected to be online in 2011, the plant's expansion enhancement doubles the capacity of the existing water treatment plant and will produce up to two-thirds of the City of Modesto's drinking water supply.

Earth-friendly reflections

Like most businesses and families we serve, MID takes earth-friendly actions every day. From providing shade trees for low-income neighborhoods to using biodiesel in our fleet of vehicles, and from encouraging our growers to follow best water practices to teaching children and their parents how to conserve energy, these actions in the past year reflected making our community a greener, healthier and more comfortable place to live.

MID exemplified environmental leadership by achieving Climate Registered™ status through The Climate Registry. The Registry, a nonprofit collaboration among Northern American states, sets consistent and transparent standards for reporting greenhouse gas emissions into a single registry. Becoming Climate Registered required calculation, verification and reporting of complete and accurate 2009 greenhouse gas emissions. This distinguished certification helps MID be better prepared to evaluate the impacts and ultimately comply with pressing greenhouse gas reduction mandates.

MID's 2009 RECYCLING NUMBERS REALLY ADD UP:

- 838 tires
- 698 refrigerators and freezers (recycled by MID customers)
- 6,088 pounds of batteries
- 15,000 pounds of paper
- 26,610 pounds of cardboard
- 55,384 gallons of motor and transformer oil
- 87,928 pounds of scrap iron
- 150,307 pounds of aluminum, copper and other cable

MID's environmental stewardship also came in the form of one of the most basic earth-friendly actions, recycling. In addition, MID ordered 40 reusable steel reels for electric cable. By using steel cable reels, the District saved 16,000 pounds of environmental wood this year.

MID also actively contributed to our community's vitality through participation in more than 100 events, sustaining strategic community partnerships with such organizations as the Stanislaus County Area Agency on Aging, Stanislaus County Housing Authority, Greater Modesto Tree Foundation and Habitat for Humanity and by fostering support for many area non-profit organizations. MID was proud to provide close to $25,000 in support to more than 75 non-profit community organizations' fundraisers and events.


Climate Registered™

FINANCE

Financial image

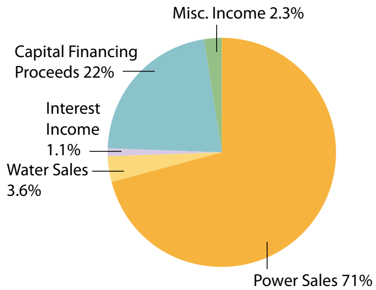
At the beginning of the year MID faced a budget shortfall of approximately $49 million. The largest piece of MID's budget – the cost of power supply – grew to $248.5 million. This was a 12 percent upward shift from 2008.

The budget shortfall and increased power supply costs combined with declining revenues, increasing debt, essential project price tags and dollars necessary for compliance with unfunded regulatory mandates formed significant financial challenges for MID in a year compounded by national economic distress.

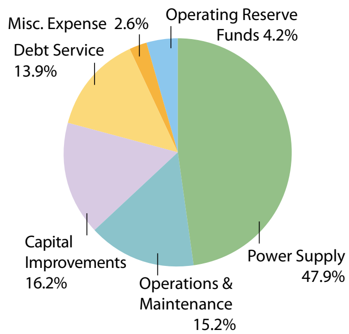
MID approved drawing down reserves by $4.5 million and increasing electric rates in three steps. Residential customers expected rate increases of seven percent in January, 6.5 percent in June and 5.4 percent in September. However, recognizing the impact of the economic recession on MID customers, midway through the year the MID Board of Directors chose to reduce the June rate increase from 7 to 2 percent and cancel the September increase. Commercial and industrial customers experienced a 10 to 17 percent rate increase.

While the rate increase rollback provided much needed relief for many customers in a difficult economic time, it didn't come without consequence. In late November, Fitch Ratings downgraded MID bonds from A+ to A. The rating outlook was characterized as stable. Fitch attributed the rating change to declining financial performance in 2007 and 2008 and decisions to reduce the original adopted 2009 electric rate increases. This downgrade will reflect higher interest rates as MID borrows money in the future.

Sources of Funds 2009



Use of Funds 2009



COMPARATIVE STATISTICS

(Dollars in Thousands)	2009	2008	2007	2006	2005
Electric Revenues					
Retail Revenues					
Residential	132,690	$122,397	$110,603	$111,989	$99,938
Commercial	87,902	83,887	77,498	76,020	67,857
Industrial	66,503	64,344	56,724	52,706	47,606
Other	12,868	13,085	10,896	9,842	9,126
Uncollectible Revenue*	(1,259)	(1,690)			
Total Retail Revenue	298,704	282,023	255,721	250,557	224,527
Wholesale Revenue	4,495	13,994	20,815	28,380	40,867
Total Electric Revenue	$303,199	$296,017	$276,536	$278,937	$265,394
Electric kWh sales (000) [1]					
Retail kWh					
Residential	893,956	896,528	881,087	914,665	875,238
Commercial	726,854	758,921	757,247	754,447	735,351
Industrial	786,935	842,303	819,968	801,578	792,027
Other	120,268	121,735	107,704	94,540	105,156
Total Retail Sales	2,528,014	2,619,487	2,566,006	2,565,230	2,507,772
Wholesale Sales	258,145	255,962	452,307	1,050,037	744,538
Total Electric Sales	2,786,159	2,875,449	3,018,313	3,615,267	3,252,310
Retail Customers at Year End					
Residential	92,160	91,598	91,360	93,372	91,061
Commercial	12,065	12,279	12,511	12,671	11,682
Industrial	144	144	210	188	173
Other	7,010	6,886	6,443	6,135	5,608
Total Retail Customers	111,379	110,907	110,524	112,366	108,524
Retail Revenue per kWh Sold (Cents)					
Residential	14.8	13.7	12.6	12.2	11.4
Commercial	12.1	11.1	10.2	10.1	9.2
Industrial	8.5	7.6	6.9	6.6	6.0
Other	10.7	10.7	10.1	10.4	8.7
System Average	11.8	10.8	10.0	9.8	9.0
Wholesale Revenue per kWh Sold (Cents)	1.7	5.5	4.6	2.7	5.5
Financial Ratios					
Operating Ratio [2]	0.85	0.95	0.87	0.80	0.81
Current Ratio [2]	1.35	1.14	1.17	1.62	1.10
Quick Ratio [2]	0.96	0.76	0.72	1.14	0.69
Debt Service Coverage - Sr. Lien Debt [1]	-	-	-	7.35	4.91
Debt Service Coverage - Jr. Lien Debt	1.10	1.10	1.49	2.31	1.91
Power Supply (GWh)					
Power Purchased	2,334.4	2,354.1	2,485.9	3,008.3	2,638.5
Power Generated	532.4	584.2	551.8	755.4	674.2
Total System Requirements	2,866.8	2,938.3	3,037.7	3,763.7	3,312.7
Annual System Peak Load (MWh)	620.0	650.0	675.2	697.3	632.5

[1] MID no longer has any outstanding Senior Lien Debt.
[2] Ratios were recalculated due to a restate of 2008 financial statements
* Uncollectible revenue included in class revenue prior to 2008
(kWh=kilowatthours; MWh=Megawatthours; GWh=Gigawatthours)

LONG TERM DEBT SUMMARY

(Dollars in Thousands)	2009	2008	2007	2006	2005
OUTSTANDING DEBT AT YEAR END					
Modesto Irrigation District Debt					
Electric Debt					
1967 Don Pedro G. O. Bonds	$ -	$ -	$ -	$ -	$ -
1996A Geysers Refunding Revenue Bonds	-	-	-	-	87,060
1999A Certificates Of Participation	40,127	42,934	45,028	47,222	49,523
1999B Certificates of Participation	35,900	37,790	39,580	41,285	42,900
2001A Certificates of Participation	85,015	87,175	89,245	91,245	93,180
2003A Certificates of Participation	80,460	82,805	85,095	87,330	89,515
2004A Certificates of Participation	50,000	50,000	50,000	50,000	50,000
2004B Certificates of Participation	66,025	66,025	66,025	66,025	66,025
2006A Certificates of Participation	123,630	131,715	139,490	146,960	-
2009A Certificates of Participation	132,145	-	-	-	-
	$613,302	$498,444	$514,463	$530,067	$478,203
Domestic Water Debt					
1998 D Refunding Revenue Bonds - Domestic Water	63,995	67,435	70,690	73,780	76,710
2007 F Revenue Bonds - Domestic Water	93,190	93,190	93,190		
	$157,185	$160,625	$163,880	$73,780	$76,710
Total Outstanding MID Debt	$770,487	$659,069	$678,343	$603,847	$554,913
MID Share Of Joint Power Agency Debt					
MSR Public Power Agency					
1993 Series F Refunding San Juan A Bonds	8,400	10,205	10,205	10,205	10,205
1997 Series G Refunding San Juan C Bonds	-	-	-	27,560	28,263
1997 Series H Refunding San Juan D Bonds	-	-	-	-	-
2001 Series I Refunding San Juan E Bonds	22,120	24,415	26,620	28,743	30,783
1995 Series B Refunding San Juan B Bonds	-	-	8,750	8,750	8,750
1995 Series C Refunding San Juan B Bonds	-	-	-	-	-
1997 Series D Refunding San Juan C Bonds	32,500	32,500	32,500	32,500	32,500
1997 Series E Refunding San Juan C Bonds	-	-	32,500	32,500	32,500
1998 Series F Refunding San Juan A&C Bonds	-	-	31,250	31,250	31,250
1998 Series G Refunding San Juan A&C Bonds	-	-	8,500	8,500	8,500
2003 Series I Refunding San Juan F Bonds	-	-	19,447	21,513	23,490
2004 Series J Refunding San Juan F Bonds	5,015	8,818	12,513	16,110	19,633
2007 Series K Refunding San Juan G Bonds	23,405	23,860	24,152	-	-
2008 Series L Refunding San Juan 1995B/1997E/2003I Bonds	59,100	59,433	-	-	-
2008 Series M Refunding San Juan 1998F Bonds	31,250	31,250	-	-	-
2008 Series N Refunding San Juan 1998G Bonds	8,500	8,500	-	-	-
	$190,290	$198,980	$206,437	$217,631	$225,874
Transmission Agency Of Northern California					
1990 Series A Revenue Bonds	$6,212	$6,011	$6,011	$6,011	$6,011
1993 Series A Revenue Bonds	2,115	3,989	5,817	7,574	9,243
2002 Series A Revenue Refunding Bonds	18,253	18,382	19,060	19,702	20,307
2003 Series A & B Revenue Refunding Bonds	40,424	39,331	39,558	39,758	39,954
2003 Series C Revenue Refunding Bonds	-	8,601	8,052	8,400	8,733
2009 Series A Revenue Refunding Bonds	15,658	-	-	-	-
2009 Series B Revenue Refunding Bonds	12,943	-	-	-	-
Commercial Paper	-	18,256	9,841	7,307	7,307
	$95,605	$94,569	$88,339	$88,752	$91,555
Total MID Share of JPA Debt	$285,895	$293,549	$294,776	$306,383	$317,429
Total Outstanding MID & JPA Debt	$1,056,382	$952,618	$973,119	$910,230	$872,342

INDEPENDENT AUDITORS' REPORT

To the Board of Directors

Modesto Irrigation District

Modesto, California

We have audited the accompanying consolidated balance sheets of the Modesto Irrigation District and its component unit (the District) as of December 31, 2009 and 2008 and the related consolidated statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2, the District consists of both enterprise funds, as reported in these consolidated financial statements, and fiduciary funds, which are excluded from these financial statements. Such fiduciary funds comprise pension plans and other postemployment benefit plans disclosed in Note 9 which are managed for the benefit of the District's employees, retirees and related beneficiaries. Because of the exclusion of these fiduciary funds, the accompanying consolidated financial statements do not purport to, and do not, present fairly the financial position of the District, as a whole inclusive of the fiduciary funds, as of December 31, 2009 and 2008, or the changes in its financial position or its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of revenues, expenses, and changes in net assets and cash flows present fairly, in all material respects, the financial position of the enterprise funds of the District as of December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, the District adopted the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, effective January 1, 2009. The financial statements for the year ended December 31, 2008 were restated to reflect the adoption of GASB Statement No. 53. In addition, the District adopted FASB Statement No. 71, Accounting for the Effect of Certain Types of Regulation, now included in the Accounting Standards Codification (ASC) 980 – *Regulated Operations*, effective January 1, 2009.To the Members of the Board of Directors

The Management's Discussion and Analysis and Schedule of Funding Progress information enclosed in this report is not a required part of the consolidated financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin

May 5, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview

The following management discussion and analysis of Modesto Irrigation District (the District) provides an overview of the financial activities and transactions for fiscal years 2009 and 2008 in the context of the requirements of the Statement of Governmental Accounting Standards (SGAS) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, as amended. This discussion and analysis should be read in conjunction with the District's audited financial statements and accompanying notes.

Financial Reporting

The District's accounting records are maintained in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board.

Explanation of Financial Statements

District financial statements include a consolidated balance sheet; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. The balance sheet provides information about assets and obligations of the District at a specific point in time. The statement of revenues, expenses and changes in net assets provides information regarding the District's operations during the fiscal year. The statement of cash flows reports cash sources and cash uses for operations, capital financing and investing activities.

Financial Summary

($ in millions)	December 31, 2009	December 31, 2008	December 31, 2007	Change from 2008 to 2009
Assets				
Utility plant, net	$654.9	$617.9	$558.1	$37.0
Other noncurrent assets and investments	230.8	211.7	281.0	19.1
Current assets	110.6	91.5	82.5	19.1
Total Assets	$996.3	$921.1	$921.6	$75.2
Liabilities and Net Assets				
Long-term debt	$758.8	$647.8	$668.3	$111.0
Current liabilities	82.2	80.0	71.4	2.2
Noncurrent liabilities	132.7	154.5	117.3	(21.8)
Net assets				
Invested in capital assets, net	(5.1)	30.3	16.0	(35.4)
Restricted	-	2.7	7.7	(2.7)
Unrestricted	27.7	5.8	40.9	21.9
Total Liabilities and Net Assets	$996.3	$921.1	$921.6	$75.2

($ in millions)	December 31, 2009	December 31, 2008	December 31, 2007	Change from 2008 to 2009
Revenues, Expenses and Changes in Net Assets				
Operating revenues	$331.0	$322.7	$316.6	$8.3
Operating expenses	(314.3)	(336.0)	(303.9)	21.7
Operating income (loss)	16.7	(13.3)	12.7	30.0
Investment and other income	9.9	7.7	14.7	2.2
Interest expense	(39.5)	(34.3)	(32.2)	(5.2)
Other non-operating income, net	(3.2)	3.2	4.2	(6.4)
Change in net assets	(16.1)	(36.7)	(0.6)	20.6
Net assets, beginning of year	38.7	64.5	66.0	(25.8)
Restatement	-	10.9	(0.9)	(10.9)
Net assets, beginning of year, as adjusted	38.7	75.4	65.1	(36.7)
Net Assets, End of Year	$22.6	$38.7	$64.5	$(16.1)

Assets

Utility plant

Utility plant increased by a net of $37.0 million in 2009. Utility plant additions of $75.0 million were primarily the result of continued construction work on the Domestic Water Treatment Plant Phase II expansion and the Advanced Meter Infrastructure (AMI) project. The increase is partially offset by depreciation expense of $32.4 million and a loss on retirement of $5.6 million.

The U.S. Department of Energy announced on October 27, 2009, that the District has been selected to receive a $1.5 million federal stimulus grant. With this grant, the District plans to install smart control equipment at key points throughout the District's electric infrastructure.

Utility plant increased by a net of $59.8 million in 2008 over 2007. In 2008, utility plant additions of $89.7 million were primarily the result of continued construction work on the Westley Rosemore Transmission Line and associated substations, and the Domestic Water Treatment Plant Phase II expansion. The increase was partially offset by depreciation expense of $29.9 million.

Additionally, in 2008, construction of new distribution system infrastructure continued as the District installed new meters and continued construction on new substations. The District also initiated two new gas-fired power plant projects: a reciprocating engine peaking plant and a jointly developed baseload plant.

Other non-current assets and investments

Other non-current assets and investments increased by $19.1 million in 2009. The increase was primarily due to an increase in restricted assets as a result of issuing the 2009A COP bonds. The District also recorded a receivable from the City of Modesto for a roof repair project for the domestic water treatment plant.

Other non-current assets and investments decreased by $69.3 million in 2008 over 2007. The decrease is primarily due to use of the general fund investments for projects that were later reimbursed through the 2009A COP issue. Other uses of bond funds were for the Westley Rosemore project and the Domestic Water Treatment Plant Expansion.

Current assets

Current assets increased by $19.1 million in 2009. The increase was attributable to an increase in customer receivables due to an 8% two-step rate increase implemented during the year.

Current assets increased from 2007 to 2008 by $9 million. The increase is due primarily to the implementation of GASB 53, Accounting and Financial Reporting for Derivative Instruments, which allows for the deferral of mark-to-market adjustments for effective hedges.

Liabilities and Net Assets

Long-term debt

Long-term debt increased by $111.0 million in 2009. This increase was primarily due to the issuance of $132.5 million in Series 2009A COP bonds. This increase was offset by $21.4 million of principal reduced through normal debt service payments.

Long-term debt decreased by $20.5 million from 2007 to 2008. This decrease was primarily due to normal debt service payments.

See Note 7 of the accompanying financial statements for additional information.

Current liabilities

Current liabilities increased by $2.2 million in 2009. The increase is primarily due to an increase in construction accounts payable resulting from large projects such as the Domestic Water Treatment Plant Phase II expansion.

Current liabilities increased by $8.6 million in 2008 over 2007. The increase was primarily due to a higher construction accounts payable amount resulting from large projects such as the Domestic Water Treatment Plant Phase II expansion.

Non-current liabilities

Non-current liabilities decreased $21.8 million in 2009. This is due primarily to a $22.5 million increase in the fair market value of derivative financial instruments with maturities greater than one year and a $6.6 million increase in the equity interest in M-S-R.

Non-current liabilities increased $37.2 million in 2008. This is due primarily to a $33.3 million decrease in the fair market value of derivative financial instruments with maturities greater than one year.

Net assets

In 2009, the District's net assets invested in capital assets decreased by $35.4 million. A $74.8 million decrease in capital assets net of related debt is primarily the result of the issuance of 2009A COP bonds. This decrease is offset by the $34.7 million change in unspent debt proceeds.

Restricted net assets decreased in 2009 by $2.7 million. This was primarily due to a decrease in debt service funds.

Unrestricted net assets changed primarily as a result of the net income in 2009 and other previous explanations. In addition the District restated net assets for the implementation of GASB 53 and a prior period correction of an error. See note 14 of the accompanying financial statements for additional information.

In 2008, the District's net assets invested in capital assets increased by $14.3 million. A $78.7 million increase in capital assets net of related debt is primarily the result of the capital additions and normal debt service payments. This increase is offset by the $64.4 million change in reserve funds.

Restricted net assets decreased in 2008 by $5.0 million. This was primarily due to a decrease in debt service funds.

Unrestricted net assets changed primarily as a result of the net loss in 2008 and other previous explanations.

Changes in Net Assets

Operating revenues

Changes from 2008 to 2009

Retail electric revenue in 2009 increased by $16.7 million or approximately 5.9%. The District implemented two rate increases during 2009. Electric retail consumption remained relatively flat in 2009 as the District's service territory experienced fewer housing starts which contributed to a smaller than anticipated revenue increase.

Wholesale electric revenue decreased by $9.5 million. The decrease was due to low wholesale prices and a critical dry water year which resulted in less excess power available to sell.

Water revenues from agricultural water remained relatively constant with revenues from prior years. Domestic wholesale water revenue decreased $1.5 million.

Equity in Joint Power Authorities increased by $2.4 million for 2009. This was a result of a $4.6 million increase in the District's equity in M-S-R Public Power Agency.

Other operating income remained relatively flat, increasing by $0.2 million.

Changes from 2007 to 2008

Retail electric revenue in 2008 increased by $26.1 million or approximately 10.2%. The District increased rates during 2008. Electric retail consumption remained relatively flat as the housing market slowed in the District's service territory.

Wholesale electric revenue decreased by $6.8 million. The decrease was due to contract expirations which resulted in less excess power available to sell on the wholesale market.

Water revenues from agricultural water remained relatively constant with revenues from prior years. Domestic wholesale water revenue decreased $6.4 million. This was a result of accounting for the year end unrealized change in the valuation of the 2007F Domestic Water Revenue Bonds interest rate swap, which is passed through to the City of Modesto.

Equity in Joint Power Authorities decreased by $6.8 million for 2008. This was a result of a $12 million decrease in M-S-R equity due to accounting for the year end realized and unrealized losses of interest rate swaps for bonds held by the Agency.

Other operating income remained relatively flat.

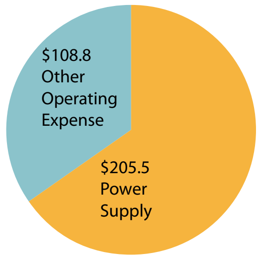
Operating expenses

Changes from 2008 to 2009

Purchased power and power generation costs for 2009 decreased by $30.0 million. This was due to a $19.9 million purchased power decrease and a $10.1 million decrease of power generation expenses as a result of lower prices for wholesale power purchases and natural gas fuel.

Other operating expenses increased by $8.3 million in 2009. The increase is primarily the result of increased overhead maintenance, NERC compliance and energy efficiency rebate costs.

2009 Operating Expense
($ in Millions)

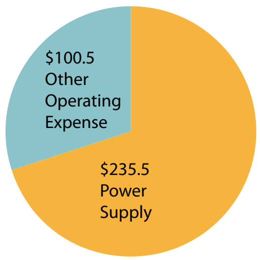


Changes from 2007 to 2008

Operating Expenses increased by $32.1 million. This was driven by purchased power and power generation cost increases of $30.0 million. Electric usage was up 2% over 2007. Fuel used for generation was higher than in 2007. Additionally, outages to the Don Pedro and San Juan plants early in 2008 forced the District to buy short term power at a time when prices were high.

Other operating expenses increased by $2.1 million in 2008. Higher costs for electric transmission and distribution and water operations were partially offset by decreased administrative and general expenses.

2008 Operating Expense
($ in Millions)



Investment and other income

Investment and other income increased in 2009 by $2.2 million. The increase was primary due to investment income for funds unspent from the Series 2009A COP issue.

Investment and other income decreased in 2008 by $7 million. The decrease was primary based on lower reserves and lower interest rates in 2008. Additionally there were unrealized losses on investments primarily due to a downgraded security.

Interest expense

Interest expense for 2009 increased $5.2 million, primarily as a result of the interest payment on Series 2009A COP bonds offset by lower interest payments on other outstanding bonds.

Interest expense for 2008 increased $2.1 million, primarily as a result of higher interest payments on outstanding bonds.

Rate Adjustment

The District increased its rates effective February 1, 2010 by 7%.

CONSOLIDATED BALANCE SHEET

December 31, 2009 and 2008
(Dollars in Thousands)

ASSETS	2009	(Restated) 2008
CAPITAL ASSETS		
Plant in service	$938,173	$904,951
Less accumulated depreciation	(383,521)	(362,589)
Plant in service - net	554,652	542,362
Construction work in progress	100,215	75,509
Total Capital Assets	654,867	617,871
OTHER ASSETS AND INVESTMENTS		
Cash and investments - restricted	106,418	72,110
Investments - unrestricted	91,708	88,476
Interest receivable - restricted	678	692
Unamortized debt issuance costs	8,391	7,850
Derivative financial instruments	963	-
Deferred cash flow hedges - unrealized loss on derivatives	18,389	40,874
Equity interest in TANC	696	1,677
Equity interest in MSR Energy Authority	-	25
Other long-term assets	3,534	-
Total Other Assets and Investments	230,777	211,704
CURRENT ASSETS		
Cash and cash equivalents - unrestricted	31,527	16,909
Cash and cash equivalents - restricted	10,513	9,015
Interest receivable - unrestricted	1,186	1,173
Customer accounts receivable, net	32,014	30,891
Wholesale power receivables, net	2,995	3,520
Materials and supplies	10,399	10,617
Prepayments	2,255	2,543
Derivative financial instruments maturing within one year	245	-
Deferred cash flow hedges - unrealized loss on derivatives	7,884	7,635
Other current assets, net	11,597	9,247
Total Current Assets	110,615	91,550
TOTAL ASSETS	$996,259	$921,125

LIABILITIES AND NET ASSETS	2009	(Restated) 2008
NONCURRENT LIABILITIES		
Long-term debt, net of current portion	$758,818	$647,832
Unamortized premium	7,737	8,236
Unamortized debt discount	(4,925)	(2,811)
Unamortized loss on advance refunding	(10,673)	(12,582)
Unearned revenue and other liabilities	41,266	34,302
Derivative financial instruments	18,389	40,874
Deferred cash flow hedges - unrealized gain on derivatives	963	-
Equity interest in M-S-R	79,863	86,504
Total Noncurrent Liabilities	891,438	802,355
CURRENT LIABILITIES		
Accounts payable and other accruals	37,162	38,518
Current liabilities payable from restricted assets		
Current portion of long-term debt	22,665	21,875
Interest payable	14,265	12,002
Derivative financial instruments maturing within one year	7,884	7,635
Deferred cash flow hedges - unrealized gain on derivatives	245	-
Total Current Liabilities	82,221	80,030
NET ASSETS		
Invested in capital assets, net of related debt	5,943	40,908
Restricted	-	2,716
Unrestricted	16,657	(4,884)
Total Net Assets	22,600	38,740
TOTAL LIABILITIES AND NET ASSETS	$996,259	$921,125

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Years Ended December 31, 2009 and 2008
(Dollars in Thousands)

	2009	(Restated) 2008
OPERATING REVENUES		
Residential, commercial and industrial electric	$298,704	$282,023
Wholesale electric	4,495	13,994
Domestic water	11,581	13,114
Irrigation water	3,696	3,603
Equity in net income of public power agencies	5,951	3,551
Other operating income, net	6,623	6,383
Total Operating Revenues	331,050	322,668
OPERATING EXPENSES		
Purchased power	167,781	187,705
Power generation	37,757	47,838
Electric resources	8,108	8,085
Electric transmission and distribution	16,924	15,034
Irrigation operations	8,181	8,060
Domestic water operations	8,081	6,543
Customer account service	5,372	5,559
Administrative and general	29,638	26,852
Depreciation and amortization	32,478	30,302
Total Operating Expenses	314,320	335,978
Operating Income / (Loss)	16,730	(13,310)
NON-OPERATING REVENUES (EXPENSES)		
Investment income	6,370	5,358
Interest expense	(37,747)	(32,388)
Capitalized interest	3,102	1,207
Amortization of debt discount and issuance costs	(808)	(725)
Amortization of premium	892	905
Amortization of loss on refunding	(1,909)	(2,043)
Other non-operating income (loss), net	(3,154)	3,166
Total Non-Operating Expenses	(33,254)	(24,520)
Change in Net Assets Before Contributions	(16,524)	(37,830)
CAPITAL CONTRIBUTIONS	384	1,140
CHANGE IN NET ASSETS	(16,140)	(36,690)
NET ASSETS - Beginning of Year (As Restated)	38,740	75,430
NET ASSETS - END OF YEAR	$22,600	$38,740

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2009 and 2008
(Dollars in Thousands)

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from electric customers	$322,743	$299,094
Payments to suppliers for goods and services	(243,186)	(236,581)
Payments to employees for services	(34,429)	(35,221)
Net Cash Flows Provided by Operating Activities	45,128	27,292
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES		
Net proceeds from issuance of long-term debt obligations	132,145	-
Repayment of long-term debt	(20,369)	(18,930)
Debt issuance costs	(3,070)	365
Construction expenditures	(71,065)	(92,485)
Interest paid	(35,484)	(31,551)
Contributions received for construction	-	168
Net Cash Flows Provided by (Used in) Capital Financing Activities	2,157	(142,433)
CASH FLOWS FROM INVESTING ACTIVITIES		
Investments purchased	(603,834)	(103,225)
Investments sold and matured	567,688	210,836
Interest received	6,371	6,476
Net Cash Flows Provided by (Used in) Investing Activities	(29,775)	114,087
Increase (Decrease) in Cash and Cash Equivalents	17,510	(1,054)
CASH AND CASH EQUIVALENTS, Beginning of Year	31,150	32,204
CASH AND CASH EQUIVALENTS, END OF YEAR	$48,660	$31,150
SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING AND INVESTING ACTIVITIES		
Accretion of capital appreciation bonds	$(1,506)	$(1,385)
Noncash contributions by developers	$384	$972
Capitalized interest	$3,102	$1,207
Amortization	$(1,825)	$(1,863)
Change in valuation of derivative financial instruments	$18,010	$(24,051)
Loss on retirement of fixed assets	$(5,635)	$0

	2009	(Restated) 2008
RECONCILIATION OF OPERATING INCOME / (LOSS) TO NET CASH FLOWS USED IN OPERATING ACTIVITIES		
Operating income / (loss)	$16,730	$(13,310)
Adjustments to reconcile operating income to net cash flows provided by operating activities		
Other non-operating income (loss)	(3,154)	3,166
Depreciation and amortization	32,478	30,302
Undistributed income from public power agencies	(5,635)	(3,576)
Change in operating assets and liabilities		
Customer accounts receivable, net	(1,123)	1,049
Wholesale power receivables, net	525	(894)
Other current assets	(5,884)	(2,037)
Materials and supplies	218	(455)
Prepayments	288	(263)
Accounts payable and other accruals	3,721	3,008
Unearned revenue and other liabilities	6,964	10,302
NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	$45,128	$27,292
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO BALANCE SHEET ACCOUNTS		
Cash and cash equivalents - unrestricted	$31,527	$16,909
Cash and cash equivalents - restricted	10,513	9,015
Investments - unrestricted	91,708	88,476
Cash and investments - restricted	106,418	72,110
Total Cash and Investments	240,166	186,510
Less: Noncash equivalents	(191,506)	(155,360)
CASH AND CASH EQUIVALENTS	$48,660	$31,150

See accompanying notes to consolidated financial statements.

NOTE 1 – Organization and Description of Business

The Modesto Irrigation District (the "District") was formed in 1887 and operates as a nonregulated special district of the State of California. The District provides electric power on an exclusive basis within a 160 square mile service area in Stanislaus County and in the Don Pedro Reservoir area in Tuolumne County. The District also provides electric power in portions of southern San Joaquin County. The District provides irrigation water to an area of California's Central Valley that lies between the Tuolumne and Stanislaus rivers. The District also operates a surface water treatment plant that provides water for the City of Modesto's (the "City") domestic water supply.

The District is managed by a Board of Directors. The District's Board of Directors has the authority to fix rates and charges for the District's commodities and services. As a public power utility, the District is not subject to regulation or oversight by the California Public Utilities Commission (CPUC). The District may also incur indebtedness including issuing bonds. The District is exempt from payment of federal and state income taxes.

NOTE 2 – Summary of Significant Accounting Policies

The financial statements of the District have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to enterprise funds of governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The significant accounting principles and policies utilized by the District are described below.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The District is presented as an enterprise fund. Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business or where the governing body has decided that the determination of revenues earned, costs incurred and net income is necessary for management accountability.

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the District's financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The District also has the option of following subsequent private-sector guidance subject to this same limitation. The District has elected to follow subsequent private-sector guidance. The District's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission (FERC).

The Modesto Irrigation District Financing Authority (the "Authority"), a joint power authority composed of the District and the City of Redding, provides financing for public improvements of the District. The District's Board of Directors serves as the Authority's Board, and District employees provide all of the Authority's administrative and management functions. All of the Authority's financial transactions, except the payment of debt service, are transacted with the District. Accordingly, all operations of the Authority are consolidated into the District's financial statements.

These consolidated financial statements present only the enterprise funds of the District and exclude the fiduciary funds of the District. The District's fiduciary funds comprise the pension plans and other postemployment benefit plans disclosed in Note 9.

Recently, the Financial Accounting Standards Board (FASB) unanimously voted that the *FASB Accounting Standards Codification* ("Codification") will be the single source of authoritative nongovernmental Generally Accepted Accounting Principles in the United States of America (GAAP) on July 1, 2009. The Codification will be effective for financial statements that cover interim and annual periods ending after September 15, 2009. Other than resolving certain minor inconsistencies in current GAAP, the Codification is not supposed to change GAAP, but is intended to make it easier to find and research GAAP applicable to a particular transaction or specific accounting issue. The Codification is a new structure which takes accounting pronouncements and organizes them by approximately 90 accounting topics.

In December 1982, FASB issued SFAS No. 71 – *Accounting for the Effects of Certain Types of Regulation*, currently included in ASC 980 – Regulated Operations, under the new Codification. This statement provides guidance in preparing general purpose financial statements for most public utilities.

The District made the decision to implement this standard effective January 1, 2009 for investment derivatives. As of December 31, 2009, the District does not have any regulatory assets which were considered investment derivatives.

In June 2008, the Governmental Accounting Standards Board (GASB) issued Statement No. 53 – *Accounting and Financial Reporting for Derivative Instruments.* This statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. The District made the decision to implement this standard effective January 1, 2009.

Presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash equivalents include all debt instruments with maturity dates of 90 days or less from the date of purchase and all investments in the Local Agency Investment Fund (LAIF), and money market mutual funds. LAIF has an equity interest in the State of California Pooled Money Investment Account (PMIA). PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA cash and investments are recorded at amortized cost which approximates market. The District's deposits with LAIF are generally available for withdrawal on demand.

Investments

Generally, all investments are carried at their fair market value, except for guaranteed investment contracts (GICs), which are carried at cost. Market values may have changed significantly after year-end.

Allowance for Doubtful Accounts

The District recognizes an estimate of uncollectible accounts for its customer accounts receivable related to electric service based upon its historical experience with collections. The District has an allowance for doubtful accounts for its electric retail customers of $3,657 and $4,037 as of December 2009 and 2008, respectively. For its wholesale power receivables, the District maintained an allowance for doubtful accounts of $172 at December 31, 2009 and 2008 due to collection issues resulting from the uncertain California wholesale energy markets. In 2009, the District also established an allowance for doubtful accounts of $300 for its miscellaneous receivables due to a large outstanding balance. The District's net expense relating to doubtful accounts for all accounts receivable is included in the accompanying statements of revenues, expenses, and changes in net assets as an offset to operating revenues. The District recorded bad debt expense of $1,258 and $1,690 at December 31, 2009 and 2008, respectively.

Materials and Supplies

Materials and supplies are generally used for construction, operation and maintenance work, not for resale. They are valued at the lower of cost or market utilizing the average cost method and charged to construction or expense when used.

Restricted Assets

Mandatory segregations of assets are presented as restricted assets. Such segregations are required by bond agreements and other external parties. Current liabilities payable from these restricted assets are so classified.

Prepayments

The balance represents payments to vendors for costs applicable to future accounting periods.

Other Current and Long-Term Assets

The balance represents miscellaneous receivables and deposits. $4,492 of the 2009 balance is a receivable from the City of Modesto for their portion of a roof replacement project for the domestic water treatment plant. Approximately $3,534 is not expected to be collected within one year.

Capital Assets

Capital assets are generally defined by the District as assets with an initial, individual cost of more than $2.5 and an estimated useful life in excess of three years.

Capital assets are stated at cost. Costs and related accumulated depreciation of assets sold or otherwise disposed of are eliminated from the accounts and related gains or losses are considered non-operating. The costs of replacement are charged to utility plant. Repair and maintenance costs are charged to expense in the period incurred. Interest costs incurred, plus amortization of deferred debt issue costs and related bond discounts/premiums, less any related interest earned during periods of construction of utility plant assets are capitalized at a rate based on the District's borrowings related to that construction.

Depreciation is computed using the straight-line method over the useful lives of the assets, which generally range from twenty to fifty years for electric and domestic water plant assets and ten to one hundred years for irrigation system assets. The estimated useful lives of furniture, fixtures, equipment and other assets range from five to twenty years.

Unearned Revenue and Other Liabilities

Billings to the City in connection with the Domestic Water Project (the "Project") in advance of the operation of the facility were recorded as unearned revenues. The unearned revenues are being amortized over the life of the facility. Annual differences between billings to the City and the District's annual Project costs are charged or credited to unearned revenues. Accordingly, the District's financial statements reflect Domestic Water operations on a break-even basis, consistent with the operating agreements between the District and the City. The balance in this account was a payable to the City of $13,514 and $11,362 in 2009 and 2008, respectively.

Other liabilities include the pension and OPEB obligations, customer meter deposits, power cost true-ups, potential rate refunds, arbitrage liability, and other miscellaneous long-term liabilities.

Asset Retirement Obligations

The District has identified potential retirement obligations related to certain transmission, distribution and irrigation canal facilities located on properties that do not have perpetual lease rights. The District's nonperpetual leased land rights generally are renewed continuously because the District intends to utilize these facilities indefinitely. Since the timing and extent of any potential asset retirements are unknown, the fair value of any obligations associated with these facilities cannot be reasonably estimated. Accordingly, a liability has not been recorded at December 31, 2009 and 2008 for these assets.

The District has identified retirement obligations for transformers that are known to contain PCB oil and has estimated a liability for the disposal of these transformers at retirement at the fair value of the obligation. The District has recorded a liability in 2009 and 2008 for this obligation in the amount of $152 and $145, respectively. This amount is included under Unearned Revenue and Other Liabilities.

The District has no other potential asset retirement obligations that represent a material asset retirement obligation (ARO). The District accrues costs related to capital assets when an obligation to decommission facilities or other liability is legally required. Additionally, the District recognizes the ARO as an increase in the capitalized carrying amount of the related long-lived asset. Annual accretions of ARO liabilities are recorded as operating expenses and the capitalized costs are depreciated over the useful life of the related long-lived assets.

Long-Term Debt

Long-term debt and other obligations are reported as liabilities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest rate method. Gains or losses on prior refundings are amortized over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Net Assets

GASB No. 34 requires the classification of net assets into three components — invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

Invested in capital assets, net of related debt — This component of net assets consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

Restricted — This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted — This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

Revenues and Expenses

The District distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. The principal operating revenues of the District are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Electric and Irrigation Revenues

Retail and wholesale electric revenues are billed on the basis of monthly cycle bills and are recorded as revenue when the electricity is delivered. The District records an estimate for unbilled revenues earned from the dates its retail customers were last billed to the end of the month. At December 31, 2009 and 2008, unbilled revenues of $16,214 and $16,140, respectively, are included in customer accounts receivable in the balance sheet.

Irrigation revenues are recognized when billed based on annual assessments, payable with installment payments due in June and December.

Purchased Power

The majority of the District's power needs are provided by power purchases. These power purchases are principally made under long-term agreements with the M-S-R Public Power Agency and the Hetch Hetchy System, owned and operated by the City and County of San Francisco. Additionally, the District purchases power from others under various power purchase agreements. Gains or losses on power purchase and sale transactions that are settled without physical delivery are recorded as net additions or reductions to purchased power expense.

Capital Contributions

Cash and capital assets are contributed to the District from customers and external parties. The value of property contributed to the District is reported as capital contributions on the statements of revenues, expenses and changes in net assets.

Effect of New Accounting Standards on Current Period Financial Statements

The Governmental Accounting Standards Board (GASB) has approved GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. Application of this standard may restate portions of these financial statements.

Comparative Data

Certain amounts presented in the prior year data have been reclassified in order to be consistent with the current year's presentation.

NOTE 3 – Cash and Investments

The District's investment policies are governed by the California Government Codes and its bond Indenture, which restricts the District's investment securities to obligations which are unconditionally guaranteed by the United States (U.S.) Government or its agencies or instrumentalities; direct and general obligations of the State of California (State) or any local agency within the State; bankers' acceptances; commercial paper; certificates of deposit; time certificates of deposit; repurchase agreements; reverse repurchase agreements or securities lending agreements; medium-term corporate notes; shares of beneficial interest; mortgage pass-through securities; financial futures and financial option contracts; and deposits with the LAIF. Investments in LAIF are unregistered, pooled funds. LAIF is a component of the Pooled Money Investment Account Portfolio managed by the State Treasurer, in accordance with Government Code Sections 16430 and 16480. The fair value of the District's investments in LAIF approximates the value of its pool shares.

The District's investment policy includes restrictions for investments relating to maximum amounts invested as a percentage of total portfolio and with a single issuer, maximum maturities, and minimum credit ratings.

Deposits in each local and area bank are insured by the FDIC in the amount of $250 for interest bearing accounts and unlimited amounts for non-interest bearing accounts as of December 31, 2009 and 2008.

The District maintains a rate stabilization fund to protect District customers from extreme rate increases that would otherwise be necessitated by dramatic short-term changes in purchased power or other operating costs. Annual transfers into and out of the fund are determined by the District's Board of Directors (Board), which may utilize these unrestricted funds for any lawful purposes. The rate stabilization fund consists of an undivided portion of the District's general operating funds. No transfers occurred during fiscal years 2009 and 2008.

Custodial Credit Risk

Deposits

Custodial credit risk is the risk that in the event of a financial institution failure, the District's deposits may not be returned to the District.

As of December 31, 2009 and 2008, $0 and $10,680 of the District's bank balances are known to be individually exposed to custodial credit risk, respectively.

	12/31/09	12/31/08
Uninsured and uncollateralized	$-	$10,680

The District's investment policy does not address this risk.

Investments

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

The District does not have any investments exposed to custodial credit risk.

The District's investment policy addresses this risk. All securities owned by the District shall be held in safekeeping by a third party custodian, acting as agent for the District under the terms of a custody agreement.

Credit Risk

Credit risk is the risk an issuer or other counterparty to an investment will not fulfill its obligations.

As of December 31, 2009 and 2008, the District's investments were rated as follows:

	Standard & Poors	
Investment Type	2009	2008
Commercial Paper	A1+	A1/P1
LAIF	NR	NR
Money Market Mutual Funds	AAAm	AAA
Federal Farm Credit Bank Notes	AAA	AAA
Freddie Mac	AAA	AAA
Federal Home Loan Bank Bonds	AAA	AAA
Fannie Mae	AAA	AAA
Corporate Medium Term Note – Lehman Brothers	NR	AAA
Corporate Medium Term Notes – Other	BB+ - A+	A+
Investment Agreement Contracts	NR	NR

The District's investment policy addresses this risk. The District limits investments to those rated, at a minimum, "A" or equivalent for medium-term notes and "A-1" or equivalent for commercial paper by a nationally recognized rating agency.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2009 and 2008 (Dollars in Thousands)

At December 31, 2009 and 2008, the District's investment portfolio was concentrated as follows:

Investment Type	Percentage of Portfolio 2009	2008
Guaranteed Investment Contracts:		
Trinity Funding Corporation	36%	0%
AIG Matched Funding Corporation	7%	25%
FSA Capital Management Services	7%	5%
Federal Home Loan Bank Bonds	11%	9%
Fannie Mae	12%	17%
Corporate Medium Term Notes	12%	14%
Federal Farm Credit Bank Notes	5%	10%
Freddie Mac	8%	7%

The District's investment policy addresses this risk and places limits on the amounts invested in specific types of investments.

Interest Rate Risk

Interest rate risk is the risk changes in interest rates will adversely affect the fair value of an investment.

Though the District has restrictions as to the maturities of some of the investments, it does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increases in interest rates. As of December 31, 2009 and 2008, the District's total portfolio, $138,704 and $106,442, is subject to interest rate risk at December 31, 2009 and 2008, respectively. $51,093 and $27,826 of this amount has maturities of one year or less as of December 31, 2009 and 2008, respectively. The remaining balances have maturities between one and five years.

NOTE 4 – Restricted Assets

Restricted Accounts

Certain proceeds of the District's debt, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net assets because their use is limited. The following accounts are reported as restricted assets:

Redemption - Used to segregate resources accumulated for debt service payments over the next twelve months.

Reserve - Used to report resources set aside to make up potential future deficiencies in the redemption account.

Project - Used to report debt proceeds restricted for use in construction.

	Carrying Value as of Year-end 2009	2008
Restricted Accounts		
Project fund	$75,567	$42,875
Reserve fund	29,744	24,225
Redemption fund	10,493	12,955
Domestic water and reserve contingency fund	1,107	1,070
Remediation fund	20	-
Total Restricted Accounts	$116,931	$81,125

Domestic Water Reserve and Contingency

As a condition of the Treatment and Delivery Agreement with the City of Modesto for domestic water, the District has established an account for the payment of emergency maintenance items that arise.

Remediation Fund

As a condition of the Natural Gas and Supply Agreement with the M-S-R Energy Authority, the District has established a fund to track proceeds received from the sale of gas delivered per the supply agreement. These proceeds will be used for future gas supply needs.

NOTE 5 – Changes in Capital Assets

A summary of changes in capital assets for 2009 follows:

	Balance 1/01/09	Increases	Decreases	Balance 12/31/09
Capital assets, not being depreciated				
Land and land rights	$27,654	$379	$-	$28,033
Capital assets being depreciated				
Electric system	666,776	37,642	11,560	692,858
Domestic water plant	104,895	9,291	5,507	108,679
Irrigation system	46,763	492		47,255
General and administrative facilities	58,863	2,750	265	61,348
Total Capital Assets Being Depreciated	877,297	50,175	17,332	910,140
Total Capital Assets	904,951	50,554	17,332	938,173
Less: Accumulated depreciation	(362,589)	(32,471)	(11,539)	(383,521)
Construction in progress	75,509	74,952	50,246	100,215
Net Capital Assets	$617,871	$93,035	$56,039	$654,86

A summary of changes in capital assets for 2008 follows:

	Balance 1/01/08	Increases	Decreases	Balance 12/31/08
Capital assets, not being depreciated				
Land and land rights	$21,414	$6,240	$-	$27,654
Capital assets being depreciated				
Electric system	613,898	53,106	228	666,776
Domestic water plant	104,772	123	-	104,895
Irrigation system	46,648	115	-	46,763
General and administrative facilities	55,511	3,352	-	58,863
Total Capital Assets Being Depreciated	820,829	56,696	228	877,297
Total Capital Assets	842,243	62,936	228	904,951
Less: Accumulated depreciation	(332,912)	(30,295)	(618)	(362,589)
Construction in progress	48,778	89,133	62,402	75,509
Net Capital Asets	$558,109	$121,774	$62,012	$617,871

NOTE 6 – Investment in Public Power Agencies

The District's investments in public power agencies are accounted for using the equity method of accounting and consist of the following at December 31, 2009 and 2008:

	2009	2008
M-S-R Public Power Agency	$(79,863)	$(86,504)
Transmission Agency of Northern California (TANC)	$696	$1,677
M-S-R Energy Authority	$-	$25

The equity method of accounting for the M-S-R Energy Authority was suspended in 2009.

M-S-R Public Power Agency

The District, the City of Santa Clara, and the City of Redding formed M-S-R Public Power Agency (Agency) for the principal purpose of acquiring electric power resources for the electric systems of its members. The District owns a 50% interest in generation assets owned by M-S-R. The District's deficit investment derives from its proportionate interest in M-S-R's deficit and the District's commitment to repay its share of M-S-R's debt, among other costs and obligations, through its take-or-pay commitment. The generation activities of M-S-R consist of a 28.8% ownership interest in a 507-megawatt (MW) unit of a coal-fired electricity generating plant located in New Mexico (the San Juan Plant). M-S-R is also a participant in the Southwest Transmission Project, a 500-kilovolt alternating current transmission line between Central Arizona and Southern California that provides a firm transmission path for the transmission of electric power from the San Juan plant. The District is obligated to make interest and other generation and transmission project related payments to M-S-R commensurate with its 50% interest in M-S-R, and receives 50% of the electrical power generated by M-S-R. In 2006, M-S-R entered into agreements with PPM Energy, Inc., now known as Iberdrola Renewables, Inc., to purchase renewable energy from the Big Horn wind project. The District's share of the Big Horn output is 12.5% and is obligated to make payments commensurate with its share of the project. During 2009 and 2008, the District incurred purchased power costs of $43,744 and $42,327, respectively, in connection with these M-S-R resources. At December 31, 2009 and 2008, the District had a payable of $342 and $192, respectively, to M-S-R for its proportionate share of project related expenditures.

Summarized financial information of the Agency is as follows at December 31:

	2009	Restated 2008
Total Assets	$259,913	$275,312
Total liabilities	$419,638	$448,317
Total net assets	(159,725)	(173,005)
Total Liabilities and Net Assets	$259,913	$275,312
Changes in Net Assets During the Year	$13,280	$4,772

The long term debt of the Agency, which totals $380,580 and $397,960 at December 31, 2009 and 2008, respectively, is secured by a pledge and assignment of the net electric revenues of the Agency and are supported by take-or-pay commitments of the participant's own net electric revenues. The District's portion of the Agency's principal and interest payments during the year were $18,155 and $16,951 for December 31, 2009 and 2008, respectively.

M-S-R Energy Authority

The District, the City of Santa Clara, and the City of Redding formed M-S-R Energy Authority (Authority) for the principal purpose to acquire, construct, maintain, operate and finance projects for the benefit of any one or more of the Members. On September 10, 2009, the Authority entered into a series of thirty-year prepaid gas contracts with Citigroup Energy, Inc., which are financed by non-recourse revenue bonds. The Authority also entered into matching Natural Gas Supply Agreements ("Supply Agreements") whereby each member is obligated to purchase the natural gas from the Authority at a discount from the Index Price. The Supply Agreements will continue in effect until September 30, 2039, unless terminated earlier due to certain defaults, as set forth therein, or the termination of the matching prepaid gas contract. If the Authority fails on any day to deliver the quantity of natural gas required to be delivered pursuant to a Supply Agreement, the member will have no obligation for any of the natural gas supply that was not delivered as a result of such delivery default.

The equity of the Authority is split between the members based on the revenues and expenses applicable to each individual member's Supply Agreement. The District's equity in the Authority's net losses exceeds its investment and, therefore, the equity method of accounting has been suspended. As of December 31, 2009, the District's unrecognized share of member's deficit of the Authority was $4,576.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2009 and 2008 (Dollars in Thousands)

Summarized financial information of the Authority is as follows at December 31:

	2009
Total Assets	$894,200
Total liabilities	$913,831
Total net assets	(19,631)
Total Liabilities and Net Assets	$894,200
Changes in Net Assets During the Year	$(19,631)

The long term debt of the Authority totaled $901,620 at December 31, 2009. The Authority did not make any principal or interest payments in 2009.

TANC

TANC is a joint power agency that owns a portion of the California Oregon Transmission Project (COTP), a transmission line between central California and southern Oregon. The District has a 21.3% ownership interest in TANC. TANC is entitled to approximately 87% of the 1,600 MW transmission capacity of the COTP. In addition, the District has a 34% share of TANC's transmission entitlement under the South of Tesla transmission agreements with Pacific Gas & Electric Company (PG&E) that provides the District with 102 MW of transmission between Tesla and Midway. The District is responsible for 34% of the South of Tesla operating costs. In July 2006, TANC changed the method used to invoice members for transmission costs. TANC began invoicing its members at the monthly TANC Open Access Transmission Tariff (OATT) rate. The OATT rate is charged to the member based on their entitlement share of kWs. During 2009 and 2008, the District incurred transmission costs of $16,416 and $16,015, respectively, relating to these projects, which are included in purchased power expense in the accompanying statements of revenues, expenses and changes in net assets. At December 31, 2009 and 2008, the District has a long-term payable of $9,757 and $8,196, respectively, to TANC relating primarily to certain non-cash expenses of TANC. This liability is included in unearned revenue and other liabilities in the accompanying consolidated balance sheets. In 2006, the District began selling excess transmission capabilities from the COTP transmission lines through TANC, as agent of the District. The District recognized $571 and $597 in revenues from transmission sales in the 2009 and 2008, respectively.

Summarized unaudited financial information of TANC is as follows at December 31:

	2009 (unaudited)	2008 (unaudited)
Total Assets	$491,624	$484,878
Total liabilities	$488,030	$476,599
Total net assets	3,594	8,279
Total Liabilities and Net Assets	$491,624	$484,878
Changes in Net Assets During the Year	$(82)	$(3,964)

The long term debt of the Agency (unaudited), which totals $435,800 and $357,000 at December 31, 2009 and 2008, respectively, is collateralized by a pledge and assignment of net revenues of each agency, supported by take-and-pay commitments of the District and the other members. Should other members of these agencies default on their obligations to the agencies, the District would be required to make "step up" payments to cover a portion of the defaulted payments. The District's portion of TANC's principal and interest payments during the year were $6,544 and $5,908 for December 31, 2009 and 2008, respectively.

Balancing Authority of Northern California (BANC)

The District and three other California municipal utilities formed BANC in 2009. BANC was formed to perform North American Electric Reliability Corporation (NERC) functions that would otherwise be performed by the BANC members or on their behalf.

Summarized financial information of BANC is as follows at December 31:

	2009
Total Assets	$172
Total liabilities	$172
Total net assets	-
Total Liabilities and Net Assets	$172
Changes in Net Assets During the Year	$-

Modesto Irrigation District Financing Authority

The Authority is a joint power authority that provides financing for public improvements of the District, and is accounted for as a component unit of the District. The revenues and expenses of the Authority are eliminated upon consolidation with the District. The Authority's summary financial information as of December 31, 2009 and 2008 and for the years then ended is as follows:

	2009	Restated 2008
Assets		
Current assets	$7,299	$7,547
Other noncurrent assets	34,017	84,831
Debt service installment receivable, less current portion	128,990	98,146
Total Assets	170,306	190,524
Liabilities and Net Assets		
Current liabilities	6,044	5,912
Derivative financial instruments	13,574	31,584
Long-term debt	149,853	153,028
Other noncurrent liabilities	835	-
Net assets	-	-
Total Liabilities and Net Assets	170,306	190,524

Revenues and Expenses

Revenues:		
Debt service contributions	7,010	4,497
Interest income	1,651	3,506
Total Revenues	8,661	8,003
Interest expense	(8,661)	(8,003)
Change in net assets	-	-
NET ASSETS, Beginning of Year	-	-
NET ASSETS, END OF YEAR	$-	$-

NOTE 7 – Long-Term Debt

Long-Term Debt

The following bonds have been issued:

Date	Issue	Final Maturity	Interest Rate	Original Amount	Outstanding Amount 12/31/09
2/26/98	1998D Domestic Water Bonds	9/1/22	4.75 – 5.50%	$94,715	$63,995
1/7/99	1999A Certificates of Participation Refunding Bonds	7/1/26	4.25 – 4.75	70,501	40,127
1/11/99	1999B Certificates of Participation Refunding Bonds	7/1/22	5.30	49,775	35,900
12/20/01	2001A Certificates of Participation Bonds	7/1/31	3.50 – 5.00	98,600	85,015
5/9/03	2003A Certificates of Participation Bonds	7/1/33	2.25 – 5.00	93,225	80,460
3/17/04	2004A Certificates of Participation Bonds	7/1/26	3.50 – 5.00	50,000	50,000
3/17/04	2004B Certificates of Participation Bonds	7/1/35	5.00 – 5.50	66,025	66,025
7/25/06	2006A Certificates of Participation Bonds	10/1/36	4.00 – 5.00	146,950	123,630
6/26/07	2007F Domestic Water Revenue Bonds	9/1/37	Index Rate	93,190	93,190
3/31/09	2009A Certificates of Participation	10/1/39	4.10 – 6.10	132,145	132,145
1/7/99	1999A Capital Appreciation Certificates – Accreted Interest	12/31/21	4.10 – 5.30	N/A	10,996

General Debt Terms

The net revenue of the District's electric system is pledged for repayment of COPs and Revenue Bonds. The Domestic Water Revenue Bonds are collateralized by a pledge of payments made by the City of Modesto relating to domestic water services.

Interest on certificates and revenue bonds is generally payable semi-annually, except for interest on certain COPs that is payable on the last day of each interest rate reset period and, interest on capital appreciation certificates (a component of COPs), which are paid at the date of maturity.

Interest earnings on tax exempt bond funds are subject to arbitrage rules of the Internal Revenue Service if interest earnings on the unspent tax exempt funds are greater than the stated bond yield on the tax exempt debt. As of December 31, 2009, the District has recorded a liability of $2,878 for a potential arbitrage rebate to the IRS. Arbitrage rebates are due five years from the issuance date of the tax exempt debt.

Required GASB 48 disclosures for pledged revenues are as follows:

Electric System	2009	2008
Principal and interest payments	$44,986	$39,536
Gross revenues	$312,065	$315,403
Total remaining principal and interest	$1,091,030	$857,278
Percent of future gross revenues	12%	10%

Domestic Water System		
Principal and interest payments	$4,112	$10,810
Gross revenues	$17,613	$22,443
Total remaining principal and interest	$269,895	$280,718
Percent of future gross revenues	57%	45%

The District is in compliance with required bond covenants.

Long-Term Debt Repayment

Revenue bonds debt service requirements to maturity follows, not including accreted interest from Capital Appreciation Bonds:

Year Ending December 31,	Principal	Interest	Total
2010	$22,665	$37,568	$60,233
2011	22,749	36,570	59,319
2012	23,038	35,650	58,688
2013	23,899	34,635	58,533
2014	24,821	33,634	58,455
2015-2019	130,101	151,049	281,150
2020-2024	142,948	118,435	261,383
2025-2029	144,010	83,766	227,776
2030-2034	147,960	46,016	193,976
2035-2039	88,295	11,898	100,193
Total Requirements	$770,487	$589,221	$1,359,708

The District had outstanding debt obligations totaling $61,287 and $64,623 at December 31, 2009 and 2008, which were defeased and excluded from the District's long-term debt.

Fair Value

The estimated fair values of the District's long-term debt, calculated using the value of each individual series based on quoted market prices for the same or similar issues at December 31, are as follows:

	2009	2008
Carrying amount	$770,487	$659,069
Fair value	755,503	713,890

Long-Term Obligation Summary

Long-term obligation activity for the year ended December 31, 2009 is as follows:

	1/01/09 Balance	Additions	Reductions	12/31/09 Balance	Due Within One Year
Domestic water revenue bonds	$160,625	$-	$3,440	$157,185	$3,605
Certificate of participation	498,444	132,145	17,287	613,302	19,060
Accreted interest on capital appreciation certificates	10,638	1,507	1,149	10,996	-
Unamortized debt discount	(2,811)	(2,304)	(190)	(4,925)	-
Unamortized premium	8,236	393	892	7,737	-
Unamortized loss on advance refunding	(12,582)	-	(1,909)	(10,673)	-
Unearned revenue and other liabilities	34,302	6,964	-	41,266	-
Derivative financial instruments	48,509	-	22,236	26,273	7,884
Equity interest in M-S-R	86,504	-	6,641	79,863	-
Totals	$831,865	$138,705	$49,546	$921,024	$30,549

Long-term obligation activity for the year ended December 31, 2008 is as follows:

	1/01/08 Balance	Additions	Reductions	12/31/08 Balance	Due Within One Year
Domestic water revenue bonds	$163,880	$-	$3,255	$160,625	$3,440
Certificate of participation	514,463	-	16,019	498,444	17,286
Accreted interest on capital appreciation certificates	10,294	1,385	1,041	10,638	1,149
Unamortized debt discount	(2,938)	(17)	(144)	(2,811)	-
Unamortized premium	8,135	1,006	905	8,236	-
Unamortized loss on advance refunding	(14,625)	-	(2,043)	(12,582)	-
Unearned revenue and other liabilities	31,533	2,769	-	34,302	-
Derivative financial instruments	8,665	39,844	-	48,509	7,635
Equity interest in M-S-R	88,889	-	2,385	86,504	-
Totals	$808,296	$44,987	$21,418	$831,865	$29,510

NOTE 8 – Derivative Instruments

Summary of Notional Amounts and Fair Values

The District enters into contracts to hedge its price exposures to power and natural gas, and to procure energy supplies. The District also enters into contracts to hedge its exposure to fluctuating interest rates. These contracts are evaluated pursuant to GASB Statement No. 53, Accounting and Financial Reporting for Derivative Instruments, to determine whether they meet the definition of derivative instruments, and, if so, whether they effectively hedge the expected cash flows associated with interest rate and energy exposures.

The District applies hedge accounting for derivatives that are deemed effective hedges. Under hedge accounting, the increase (decrease) in the fair value of a hedge is reported as a deferred cash flow hedge on the consolidated balance sheet. For the reporting period, all of the District's derivatives meet the effectiveness tests.

For energy derivatives, fair values are estimated by comparing contract prices to forward market prices quoted by third party market participants or provided in relevant industry publications. For interest rate derivatives, the District subscribes to a financial information service that it uses to verify fair value estimates obtained from its counterparties.

The following is a summary of the fair values and notional amounts of derivative instruments outstanding as of December 31, 2009 (amounts in thousands; gains shown as positive amounts, losses as negative).

	2009 Change in Fair Value		Fair Value, End of 2009		Notional
	Classification	Amount	Classification	Amount	(Thousands)
Effective Cash Flow Hedges					
Interest Rate Derivatives:					
Pay-fixed swaps, interest rate	Deferred Inflow	$18,009	Derivative	$(13,574)	$93,190
Energy Derivatives:					
Forward contracts	Deferred Outflow	(1,178)	Derivative	(1,180)	270 MWh
Futures contracts	Deferred Outflow	(385)	Derivative	(919)	310 mmBtu
Pay-fixed swaps, natural gas	Deferred Inflow	5,344	Derivative	(9,392)	5,602mmBtu
Pay-fixed swaps, power	Deferred Inflow	1,656	Derivative	-	0 MWh

The following is a summary of the fair values and notional amounts of derivative instruments outstanding as of December 31, 2008 (amounts in thousands; gains shown as positive amounts, losses as negative).

	2008 Change in Fair Value		Fair Value, End of 2008		Notional
	Classification	Amount	Classification	Amount	(Thousands)
Effective Cash Flow Hedges					
Interest Rate Derivatives:					
Pay-fixed swaps, interest rate	Deferred Inflow	$(24,051)	Derivative	$(31,584)	$93,190
Energy Derivatives:					
Forward contracts	Deferred Outflow	-	Derivative	-	
Futures contracts	Deferred Outflow	(712)	Derivative	(534)	310 mmBtu
Pay-fixed swaps, natural gas	Deferred Inflow	(16,249)	Derivative	(14,735)	7,314mmBtu
Pay-fixed swaps, power	Deferred Inflow	(1,656)	Derivative	(1,656)	62 MWh

Objective and Terms of Hedging Derivative Instruments

The objectives and terms of the District's hedging derivative instruments that were outstanding at December 31, 2009 are summarized in the next table. The table is aggregated by the credit ratings of the District's counterparties. For counterparties having multiple ratings, the rating indicating the greatest degree of risk is used.

The interest rate swaps are designed to synthetically fix the cash flows associated with variable rate bonds. The interest rate that the District pays on the 2007F bonds is 67% of LIBOR plus a spread. With the interest rate swaps, the District pays the counterparty a fixed rate and receives 67% of LIBOR. Netting out the LIBOR-based payments, the District's effective interest rate is the sum of the fixed rate paid to the swap counterparty and the spread.

The District hedges its power and natural gas costs so that it can offer predictable rates to its retail electric customers and support its credit rating. The District maintains a Risk Management Program (RMP) to control the price, credit, and operational risks arising from its power and natural gas market activities. Under the RMP, authorized District personnel assemble a portfolio of swaps, futures, and forward contracts over time with the goal of making the District's purchased power and fuel budget more predictable.

Objectives and terms of the District's hedging derivative instruments that were outstanding at December 31, 2009 are summarized in the table below:

Type	Objective	Notional (Thousands)	Effective Date	Maturity Date	Terms	Counterparty Rating
Pay-fixed swaps, interest rate	Hedge cash flows on the 2007F bonds	$93,190	Jun-07	Sep-37	Pay 4.378-4.440%; Receive 67% of LIBOR	A/A
Forward contracts, power	Hedge cash flows on NP15 power purchases	55 MWh	Aug-08	Dec-10	Pay $79.00/MWh; Settle on CAISO NP15	AA/Aa
Forward contracts, power	Hedge cash flows on NP15 power purchases	31 MWh	Oct-07	Sep-10	Pay $94.25/MWh; Settle on CAISO NP15	A/A
Forward contracts, power	Hedge cash flows on NP15 power purchases	184 MWh	Oct-03	Sep-15	Pay $66.75-70.34/MWh; Settle on CAISO NP15	BBB/Baa
Futures contracts, natural gas	Hedge cash flows on PG&E citygate gas purchases	310 mmBtu	Aug-08	Oct-10	Pay $8.680-8.820/mmBtu; Settle on NYMEX	N/A
Pay-fixed swaps, natural gas	Hedge cash flows on power contract indexed to AECO gas	1,825 mmBtu	Jan-07	Dec-10	Pay $4.785-8.205/mmBtu; Receive CGPR AECO price	A/A
Pay-fixed swaps, natural gas	Hedge cash flows on PG&E citygate gas purchases	3,777 mmBtu	Dec-07	Dec-13	Pay$6.650-10.345/mmBtu; Receive NGI PG&E citygate price	A/A

Objectives and terms of the District's hedging derivative instruments that were outstanding at December 31, 2008 are summarized in the table below:

Type	Objective	Notional (Thousands)	Effective Date	Maturity Date	Terms	Counterparty Rating
Pay-fixed swaps, interest rate	Hedge cash flows on the 2007F bonds	$93,190	Jun-07	Sep-37	Pay 4.378-4.440%; Receive 67% of LIBOR	A/A
Pay-fixed swaps, power	Hedge cash flows on NP15 power purchases	62 MWh	Aug-08	Oct-09	Pay $76.00-94.50/MWh; Settle on CAISO NP15	A/A
Futures contracts, natural gas	Hedge cash flows on PG&E citygate gas purchases	310 mmBtu	Aug-08	Oct-10	Pay $8.680-8.820/mmBtu; Settle on NYMEX	N/A
Pay-fixed swaps, natural gas	Hedge cash flows on power contract indexed to AECO gas	3,103 mmBtu	Feb-06	Dec-10	Pay $7.000-8.560/mmBtu; Receive CGPR AECO price	A/A
Pay-fixed swaps, natural gas	Hedge cash flows on PG&E citygate gas citygate price	4,211 mmBtu	Nov-05	Dec-12	Pay $7.470-12.300/mmBtu; Receive NGI PG&E purchases	A/A

Risks of Derivative Instruments

Credit risk – Credit risk is the risk of loss due to a counterparty defaulting on its obligations. The District seeks to minimize credit risk by transacting with creditworthy counterparties. Interest rate swap counterparties are evaluated at the time of transaction execution. For energy counterparties, the District follows a procedure under its RMP wherein the District will accept more potential credit risk from counterparties having greater amounts of tangible net worth and higher credit ratings. The procedure prohibits the District from executing energy hedge transactions with counterparties rated lower than BBB by Standard & Poor's or Fitch rating services, or Baa2 by Moody's.

The District uses industry standard agreements to document derivative transactions. These agreements include netting clauses whereby, if the District and the counterparty owe each other payment, the party owing the greater amount pays the net. The District also uses collateral posting provisions to manage credit risk. These provisions require an out-of-the-money party to post cash, letters of credit, or other pre-agreed highly liquid securities to the extent that the mark-to-market value of derivative positions with a given counterparty exceeds a threshold value. Thresholds are negotiated individually with counterparties, and the netting provisions include rights to set off against posted collateral.

To avoid concentrations of credit risk, and to avoid the risk of itself having to post large amounts of collateral, the District seeks to spread transactions across counterparties so that, even with an adverse move in the market, the threshold values would likely not be exceeded. As of December 31, 2009 and 2008, the District did not have any collateral posted with its derivative counterparties and did not hold any collateral posted by its counterparties.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2009 and 2008 (Dollars in Thousands)

The District is exposed to credit risk to the extent that it has net fair value gains on its derivative positions with individual counterparties. As of December 31, 2009, the District was in-the-money with two counterparties. The first is rated BBB/Baa and the amount is $936; the second is rated A/A and the amount is $11. If the counterparties failed, those value amounts could be lost. As of December 31, 2008, the District was in the money with none of its counterparties.

Basis risk – Basis risk is the risk that arises when a hedged item and a derivative that is attempting to hedge that item are based on different indices. The District is exposed to basis risk when it hedges its natural gas purchases, which are priced at the PG&E citygate index, with NYMEX futures contracts, which settle based on the price in Henry Hub, Louisiana. If the markets diverge such that PG&E citygate prices increase relative to Henry Hub prices, the District would be negatively affected on the futures contracts that it has maturing in 2010.

Termination risk – Termination risk is the risk that a derivative will terminate prior to its scheduled maturity due to a contractual event. Contractual events include bankruptcy, illegality, default, and mergers in which the successor entity does not meet credit criteria. One aspect of termination risk is that the District would lose the hedging benefit of a derivative that becomes subject to a termination event. Another aspect of termination risk is that, if at the time of termination the mark-to-market value of the derivative was a liability to the District, the District could be required to pay that amount to the counterparty. Termination risk is associated with all of the District's derivatives up to the fair value amounts.

Hedged Debt

Net cash flows for the District's synthetic fixed-rate debt are shown below. These amounts assume that the interest rates of the bonds and the reference rates of the hedging derivative instruments remain at December 31, 2009 levels. These rates will vary and, as they do, interest payments on the variable-rate bonds and net receipts/payments on the interest rate swaps will vary. The table shows only the District's effectively hedged synthetic fixed-rate debt, which is a subset of the District's total debt. As of December 31, 2009, all of the District's variable-rate debt is effectively hedged.

Year Ending December 31,	Principal	Interest	Net Payment on Derivatives	Total
2010	$-	$732	$3,363	$4,095
2011	-	732	3,363	4,095
2012	-	732	3,363	4,095
2013	-	732	3,363	4,095
2014	-	732	3,363	4,095
2015-2019	-	3,659	16,817	20,476
2020-2024	8,730	3,611	16,582	28,923
2025-2029	25,550	2,916	13,231	41,697
2030-2034	32,040	1,798	8,119	41,957
2035-2037	26,870	411	1,857	29,139
Totals	$93,190	$16,056	$73,422	$182,668

NOTE 9 – Employee Benefit Plans

The District maintains two retirement plans and a retiree medical benefits plan for its eligible employees. The Retirement Committee of the District's Board of Directors oversees the plans. The District has a Retirement Department that performs plan administrative functions. Plan investments are managed by the District Treasury Department and third-party investment managers. All funds of the plans are separate assets of the retirement plans, and are not assets of the District.

Basic Retirement Plan

Plan Description. The Basic Retirement Plan (the Plan) is a single-employer noncontributory defined benefit pension plan for eligible employees. The Plan provides retirement, disability and death benefits to plan members and beneficiaries. The District issues publicly available financial statements and required supplementary information of the Plan.

Annual Pension Cost. The District contributes at an actuarially determined rate. The annual required contribution was determined in accordance with the projected unit credit actuarial cost method. The actuarial value of assets is based on fair market valuations prepared by an appraisal service. The unfunded liability is amortized over a 30-year period using the "rolling amortization" approach. The amortization period is still open. Significant assumptions used to determine the actuarial accrued liabilities as of January 1, 2009, the most recently completed actuarial valuation, include the following, all reflecting annual compounding:

- Rate of return on the investment of present and future assets of 7.75% per year;
- Discount rate applied to the pension benefit obligation of 7.75% per year;
- Salary increases of 3.5% per year; and
- Cost of living increases to retirees of 3% per year.

The District's annual pension cost and net pension obligation for 2009 and 2008 were as follows:

	2009	2008
Annual required contribution	$9,602	$8,009
Interest on net pension (prepaid) obligation	139	103
Adjustment to annual required contribution	(177)	(87)
Annual Pension Cost	9,564	8,025
Contributions made	9,602	7,380
Increase (Decrease) in net pension obligation	(38)	(645)
Net pension obligation, beginning of period	1,977	1,332
Net Pension Obligation, End of Period	$1,939	$1,977

Funding Policy. The Board of Directors has established, and may amend, the contribution requirements for Plan members and the District set forth in the terms of the Plan. The Terms of the Plan empower the Retirement Committee of the District (the Committee) to make, at reasonable intervals, an analysis of the funding requirements of the Plan for the payment of retirement benefits and expenses, based on reasonable actuarial assumptions and methods which take into account the experience of the Plan and the reasonable expectations, and on the basis of this analysis, to establish a funding policy for the Plan. The terms of the Plan state that, subject to the Board of Directors' right to suspend or reduce contributions to the Plan at any time, the District shall contribute to the Plan at least once a year, the amounts necessary to maintain the Plan on a sound actuarial basis, in a manner consistent with the funding policy established by the Committee.

The funding policy currently established by the Committee requires the District to contribute an amount set forth in the Recommendation Regarding Total Contributions presented in the Plan actuary's 2009 Actuarial report. The Required Annual Contributions set forth in the Recommendation regarding total contributions presented in the Actuarial Report are $9,564 and $8,025 which were contributed January 2, 2009 and 2008 for 2009 and 2008, respectively.

The District is the sole contributing entity. Prior to 1989, participants were allowed to make voluntary contributions and prior to 1977, participating contributions were required.

Certain historical trend information is summarized as follows:

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (Prepaid)	Net Change in Net Pension Obligation
12/31/09	$9,564	100%	$1,939	$(38)
12/31/08	8,025	92%	1,977	645
12/31/07	7,511	106%	1,332	(439)

The schedule of funding progress is presented below:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
01/01/09	$143,388	$192,169	$48,781	74.6%	$32,131	151.8%
01/01/08	147,037	178,276	31,239	82.5%	32,299	96.7%
01/01/07	134,628	163,698	29,069	82.2%	28,622	101.6%

Supplemental Retirement Plan

Eligible employees of the District also participate in the District's supplemental retirement plan (the Supplemental Plan). The Supplemental Plan is a defined contribution plan and serves as partial or full replacement of social security for participants, depending upon date of employment. Participants are required to contribute 5% of their compensation on a pre-tax basis. The District wholly matches the contributions. Participants become fully vested in the District's portion of their account after six months of employment. Covered payroll of Participants is the same as under the Basic Retirement Plan. Participants have three investment options, a fund comprised of short-term fixed income money market securities, managed by the District's Treasury Department, a fund comprised primarily of equities, managed by third party investment managers, and a fund comprised of long-term fixed income securities, managed by third party investment managers. The District made contributions to the Supplemental Plan of $1,716 and $1,759 for 2009 and 2008, respectively.

Health Care Benefits

Plan Description. The Retiree Health Program is a single-employer defined benefit healthcare plan. The District provides health care benefits, in accordance with District policy, to qualified retirees and their spouses. The qualification requirements for these benefits are similar to those under the District's retirement plans.

Funding Policy. Currently 267 retirees and surviving spouses meet those eligibility requirements. The District contributes the full cost of coverage for employees who retired before 1992; employees who retire in 1992 and thereafter pay a portion of the monthly premium for eligible dependent coverage, and the District pays the remainder of the cost of the plan. Covered retirees are also responsible for personal deductibles and co-payments. The District pays for post-retirement dental and vision care for retirees only to age 65.

Annual OPEB Cost and Net OPEB Obligation. The District contributes at an actuarially determined rate. The annual required contribution was determined in accordance with the projected unit credit actuarial cost method. The actuarial value of assets is based on fair market valuations prepared by an appraisal service. Significant assumptions used to determine the actuarial accrued liabilities as of January 1, 2009, the most recently completed actuarial valuation, include the following, all reflecting annual compounding:

- Rate of return on the investment of present and future assets of 7.75% per year;
- An assumed inflation rate of 3.0% per year;
- Salary increases of 3.5% per year; and
- Projected health care cost increases of 6.0% for medical plans in 2009 trending to 5.0% in 2011 and thereafter and 3.0% per year for vision and 4.0% per year for dental for all future periods.

The District's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over thirty years as a percentage of rising covered payroll. The following table illustrates the amount actually contributed to the plan, and changes in the District's net OPEB obligation (dollar amounts in thousands).

	2009	2008
Annual required contribution	$6,222	$5,395
Interest on net OPEB obligation	175	418
Adjustment to annual required contribution	14	(299)
Annual OPEB cost (expense)	6,411	5,514
Contributions made	6,323	5,422
Increase in net OPEB obligation	88	104
Net OPEB obligation, beginning of period	711	607
Net OPEB Obligation, End of Period	$799	$711

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2009, 2008 and 2007 were as follows (dollars in thousands):

Fiscal Year Ending	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
12/31/09	$ 6,411	98.63%	$799
12/31/08	5,514	98.33%	711
12/31/07	5,127	88.17%	607

The schedule of funding progress was as follows for 2009 and 2008 (dollars in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
01/01/09	$8,887	$74,688	$65,801	11.90%	$32,463	202.70%
01/01/07	4,198	56,238	52,040	7.46%	30,038	173.25%

Actuarial valuations of an ongoing plan involve estimates for the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

The required schedule of funding progress immediately following the Notes presents trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing benefit costs between the employer and plan members to that point. Actuarial calculations reflect a long-term perspective. The methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

NOTE 10 – Commitments

The District purchases most of its purchased power from M-S-R (Note 6) and through the following long-term agreements:

The City and County of San Francisco Power Purchase Agreement

The City and County of San Francisco (CCSF) Power Purchase Agreement (Agreement) titled the "Amended and Restated Long Term Power Sales Agreement" (ARLTPSA) was amended in 2007 and is now titled the "Long Term Energy Sales Agreement between the City and County of San Francisco and the Modesto Irrigation District" (LTESA). Under the LTESA, CCSF sells as available generated energy to meet the District's Class One requirements through 2015. Class One power is limited to power necessary for municipal and pumping loads pursuant to the Raker Act (the 1913 federal law enabling construction of the Hetch Hetchy project in the national park). The cost for Class One power is at a price that reimburses CCSF for developing, maintaining, and transmitting such energy to the District.

The LTESA provides Class One power for the District at a minimum schedule of 40% of the capacity for the month and the agreement expires on June 30, 2015. The District's purchases under the LTESA in 2009 and 2008 totaled $1,826 and $1,251, respectively. Total commitments under this agreement over the next five years are as follows as of December 31, 2009:

2010	$1,481
2011	1,551
2012	1,618
2013	1,697
2014	1,778

Other Energy Purchase Commitments

The District has a number of other power and natural gas purchase agreements with various entities, which provide for power and fuel deliveries, under various terms and conditions through 2015. Total commitments under these agreements over the next five years are as follows as of December 31, 2009:

2010	$97,228
2011	77,284
2012	74,968
2013	64,350
2014	56,634

NOTE 11 – Contingencies

California Energy Market Refund Dispute

In 2001, FERC issued an order establishing evidentiary hearings for the purpose of determining the amount of refunds, if any, due to customers of the California ISO and PX spot markets from market participants selling into those markets for the period October 2, 2000 through June 20, 2001 (the refund period). During this time period, the District was both a seller and a buyer in the California spot markets. In a FERC proceeding on this matter beginning in 2007, the Administrative Law Judge (ALJ) assigned to the proceedings adopted hearing procedures that, among other issues, addressed the calculation of refunds and identification of the amount currently owed to each supplier (with separate quantities due from each entity) by the California ISO, the investor owned utilities, and the State of California. In December 2002, the ALJ issued his Certification of Proposed Findings, and in March 2003, FERC issued an Order (the March Order) accepting most of the Findings and adjusting the formula used to calculate the mitigated market-clearing price (MMCP) to be used in resettling the markets during the refund period. This formula subsequently was adjusted to account for natural gas market manipulation.

The District challenged FERC's authority to order refunds from it, due to its status as a municipal utility. In September 2005, the Ninth Circuit found that FERC does not have refund authority over wholesale power sales made by governmental entities and other non-public utilities, including the District. On March 7, 2007, the Ninth Circuit denied the California Parties' petition for rehearing and rehearing en banc as to the September 2005 decision. One of the California Parties filed a petition for writ of certiorari to the U.S. Supreme Court, which was denied. The mandate has issued for the September 2005 decision and proceedings have begun at FERC to determine how the Ninth Circuit's decision should be implemented. FERC appears to be refraining from ordering any amounts owing to the District from being released until further notice or until the ISO completes its refund calculations.

In August 2006, the Ninth Circuit issued a decision, as amended, which could have expanded the scope of transactions for which the District would have been required to pay refunds, but for the September 2005 decision addressing jurisdiction. The August 2006 decision requires FERC to review certain evidence in considering whether to open up the time period for refunds back to May 2000. The decision also requires FERC to review multi-day transactions, but denies refunds for bilateral sales, including to the California Energy Resources Scheduling ("CERS") division of the California Department of Water Resources ("CDWR") (though a case remanded from the Ninth Circuit as to Pacific Northwest transactions will require FERC to look at further information in determining whether to order refunds for transactions to CERS). The California Parties may also use such ruling to support their cases in the civil proceedings discussed below. The mandate for the Ninth Circuit's August 2006 decision has issued and the case has returned to FERC. FERC has open a hearing, currently stayed pending settlement talks, to address certain issues remanded to it by the Ninth Circuit. While the District believes that FERC proceedings on remand should not involve the District, due to the District's non-jurisdictional status, it is unclear whether the California Parties will seek to include the District. Also, while the scope of the hearing procedures would focus on individual, market participant behavior, FERC has not specified any remedies, and the District expects that the California Parties will continue to advocate for market-wide remedies. Depending on how the scope of the remanded FERC proceeding evolves, the California Parties may seek to apply FERC's rulings on remand against the District before the California State courts, as described below. Under the latest MMCP formula announced by FERC, the District estimates its potential refund exposure to be in the range of $4,900 to $7,700, though the range may be increasing due to potential, accrued interest, if ordered by a court.

Claims for 2000 and 2001 Power Sales

Following the Ninth Circuit's jurisdictional ruling in September 2005, the California Parties began to seek refunds through other jurisdictions. In December 2005, the California Parties presented a claim for damages pursuant to California Government Code §905 et seq. ("Tort Claims Act"). The California Parties' claim arises from the District's power sales from May 1, 2000 through June 20, 2001 in the wholesale electricity markets operated by the California ISO and the California PX. The California Parties allege that the District is contractually obligated under the California PX Participation Agreement and/or the ISO Scheduling Coordinator Agreement to reimburse the California Parties for any amounts that FERC might find were unjust under the California Refund Proceedings. The District returned the claim without action as untimely filed. In March 2006, the California Parties filed lawsuits in the Federal District Court for the Eastern District of California, Sacramento Division. The District, in conjunction with other municipal entities, filed motions to dismiss for failure to state a claim, raising defenses such as expiration of the statute of limitations and lack of standing. Other entities argued that the U.S. District Court had no jurisdiction to hear the claims. On October 24, 2006, the Federal District Court heard oral argument on the issue concerning subject matter jurisdiction. The judge deferred oral argument on the issue of failure to state a claim. On March 16, 2007, the judge issued an order dismissing both complaints before him for lack of subject matter jurisdiction.

The judge's order has been appealed by the California Parties to the Ninth Circuit. On April 9, 2007, the California Parties filed a Complaint in state Superior Court in Los Angeles against the District and other entities, seeking substantively similar relief as they did in the U.S. District Court, Eastern District. The California Parties have served their Complaint on the District.

On January 3, 2006 the Attorney General of the State of California and the California Department of Water Resources (collectively, the State) presented a claim for damages pursuant to the Tort Claims Act. The State's claim arises out of the District's power sales into the California IS0/ California PX from October 2, 2000 through June 20, 2001. Similar to the California Parties' claim, discussed above, the State alleges that the District is contractually obligated under the California PX Participation Agreement and the ISO Scheduling Coordinator Agreement to reimburse the State for any amounts that FERC might find were unjust under the California Refund Proceedings. The District returned the claim without action as untimely. On June 14, 2006, the State filed a lawsuit against the District. On February 23, 2007, the Plaintiffs served their Complaint on the District, triggering the time period for the District to answer. On February 28, 2007, the District and other entities entered into tolling agreements with the State. As an outcome of the tolling agreement, on March 1, 2007, the State moved to dismiss its Complaint against the District without prejudice.

The District has been defending against these suits. With regard to the claims pending in California State Superior Court, discovery on the liability phase of the case has completed, and motions for summary judgment were scheduled to be heard on April 7, 2010. However, the Superior Court Judge has conveyed a preference to defer oral argument and consideration of Defendants' summary judgment motions until resolution of an appeal pending before the U.S. Court of Appeals for the Ninth Circuit, which concerns whether FERC has the authority to reset ISO/PX Tariff prices retroactively. The District has participated in submitting an initial petitioners' brief in that appeal, which continues briefing through July 2010. The Superior Court Judge conveyed that he thought that the outcome of the appeal was crucial to the viability of Plaintiffs' claims. The Superior Court Judge will receive briefs and potentially hear oral argument on April 30, 2010 on whether to order a stay. While not officially taken off calendar, the May 13, 2010 trial date has effectively been deferred, and oral argument on the summary judgment motions has been deferred.

The District has stated that this estimated range, in the exposure noted above, accounts for the plaintiffs' positions before the FERC, and on appeal to the U.S. Courts of Appeal and before the civil courts, concerning potential increased refund liability due to claims for an extended period, for a larger universe of transactions and other adjustments to the proxy price desired by the plaintiffs which would increase refund liability. While the plaintiffs may have the opportunity to refresh their arguments before the Eastern District Court and state court, the District will be able to refresh arguments it had raised before the FERC, but which were rejected, e.g., that the District made sales under emergency conditions to the ISO, which we contend is a mitigating factor in deciding whether the District ought to be held liable for paying refunds.

These parties' lawsuits make it possible that netting of the District's accounts receivable and the District's refund liability may not occur through the same administrative mechanism. It may be that these processes will be bifurcated. The District also estimates that a payment for some part of the California Parties' claims is probable in these proceedings, given the aggressiveness of the California Parties' claims.

With regard to the issue of refunds for a longer refund period than that ordered by the FERC, i.e., starting the refund period from May 2000 rather than from October 2, 2000, it is the District's conclusion that it is currently impossible to determine whether it is probable that the above-referenced plaintiffs and potential plaintiffs will be able to obtain refunds for the lengthened period. Those parties rely on the U.S. Court of Appeals for the Ninth Circuit decision, *State of California, ex. rel. Bill Lockyer v. FERC,* 383 F.3d 2006 (2004), and other pending litigation, e.g., an appeal in Ninth Circuit case number 01-71051, *et. al*., to support their claim for refunds for the extended period and *Public Utils. Comm'n of the State of California v. FERC,* 456 F.3d 1025, *as amended* 426 F.3d 1027 (2006) *as amended* Aug. 31, 2006. Those parties have received substantial opposition to their positions, and thus far, FERC has issued rulings in at least the Lockyer case that deny the California Parties' requests to extend market-wide remedies for a lengthened period. Moreover, the FERC has not applied its proxy price methodology for the pre-October period. In addition, the California Parties have pursued their CERS claim in the Puget Sound case, and it will be difficult to see the impact of decisions concerning that arena on transactions with CERS, if any, until FERC applies those decisions.

In the meantime, the U.S. Court of Appeals for the Ninth Circuit has been mediating settlement efforts which are ongoing, and in which the District has been participating.

Although the California Parties' lawsuits and the State's claims do not specify the amount of damages that the California Parties seek, the District expects that the amounts would parallel the refund that the District would owe to the market if it were subject to the FERC-based refund liability. Under the latest MMCP formula prescribed in the FERC proceedings, the District estimates its potential refund exposure to be in the range of $4,900 to $7,700, though the range may be increasing due to potential, accrued interest, if ordered by a court.

As such, the District has maintained an accrued liability of $4,919 related to their contingent refund obligations at December 31, 2009.

Domestic Water Plant Potential Litigation

Although no specific claims are pending, it is reasonable to assume that in connection with the Modesto Regional Water Treatment Plant Phase Two Expansion Project, claims will be asserted in the future by and against the District. The District anticipates the completion of the expansion project will, ultimately, be delayed by somewhere between 12 and 16 months. By virtue of that delay, as well as remedial action which the District has been required to undertake and will undertake in the future, multi-million dollar cost overruns are anticipated. It is the District's firm belief that the responsibility for the anticipated cost overrun lies with the general contractor, its subcontractors, suppliers and project manager.

General Contingencies

In the normal course of operations, the District is party to various claims, legal actions and complaints. However, the District's counsel and management believe that the ultimate resolution of these matters will not have a significant adverse effect on the financial position or results of operations of the District.

Open Contracts

The District has open contracts for approximately $80,464 for the domestic water plant expansion and a roof replacement project. As of December 31, 2009, approximately $73,870 has been expended.

Electric Purchase Contracts. The District has entered into numerous electric purchase contracts with amounts totaling 3.2 million megawatt hours (MWh) for the purpose of fixing the rate on the District's electric power purchases. These electric purchase contracts result in the District paying fixed rates ranging from $40 to $94.25 per MWh. These contracts expire periodically from March 2010 through June 2026. In addition, the District has entered into contracts for power generated by hydroelectric and wind resources where the amount and cost will depend on weather variables. The hydro and wind contracts expire periodically from June 2015 through December 2035.

Gas Purchase Contracts. The District has entered into numerous gas purchase contracts for the purpose of fixing the rate on the District's natural gas purchases for its gas-fueled power plants. These gas purchase contracts result in the District paying fixed rates ranging from $4.785 to $10.54 per million British Thermal Units (mmbtu). The amounts total to 10.2 million mmbtu and the contracts expire periodically from March 2010 through December 2013.

NOTE 12 – Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors and omissions; workers compensation; and health care of its employees. These risks are covered through the purchase of commercial insurance. The District is self insured for general and liability claims up to $1,000. The District also has excess liability insurance for claims over $1,000. There was no significant decrease in coverage over the prior year. Settled claims have not exceeded insurance coverage in each of the past three years. Claims are paid as they are incurred. Total accrual and payment history is shown below.

	2009	2008	2007
Claims liability – beginning of year	$-	$-	$-
Claims accrued	231	199	556
Claims paid/other	(231)	(199)	(556)
Claims Liability - End of Year	$-	$-	$-

NOTE 13 – Subsequent Event

Rate Adjustment

The District implemented a 7% rate increase effective February 1, 2010.

Smart Grid Investment Grant

The District has approved the Smart Grid Investment Grant Assistance Agreement with the Department of Energy. This agreement will supply reimbursement for up to 50 percent of the 2010 Smart Grid project costs or approximately $1,500.

NOTE 14 – Restatement of Net Assets

Net assets have been restated due to the implementation of GASB Statement No. 53 and for the correction of a prior period error for an unrecognized liability.

During 2009, the District determined that it was not recording a liability for its obligation to provide energy to the City and County of San Francisco based on an energy exchange services agreement entered into in 2006. The impact of the error correction on the change in net assets for 2008 was an additional expense of $3,057, and a reduction of the expense of $1,499 in 2009.

Net Assets – December 31, 2007 (as originally stated)	$64,554
Prior period adjustment for GASB Statement No. 53 implementation	19,616
Unearned revenue for domestic water related to the interest rate swap	(7,533)
Liability incurred previously not recognized	(1,207)
Net Assets – December 31, 2007 (As Restated)	$75,430

REQUIRED SUPPLEMENTARY INFORMATION

Unaudited December 31, 2009 and 2008 (Dollars in Thousands)

Other Post Employment Benefits (OPEB) Required Supplementary Information

The schedule of funding progress, presented as required supplementary information, present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

The schedule of funding progress as of December 31, 2009 is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
01/01/09	$8,887	$74,688	$65,801	11.90%	$32,463	202.70%
01/01/07	4,198	56,238	52,040	7.46%	30,038	173.25%

Basic Retirement Plan Required Supplementary Information

The schedule of funding progress, presented as required supplementary information, present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

The schedule of funding progress as of December 31, 2009 is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c
01/01/09	$143,388	$192,169	$ 48,781	74.6%	$ 32,131	151.8%
01/01/08	147,037	178,276	31,239	82.5%	32,299	96.7%
01/01/07	134,628	163,698	29,069	82.2%	28,622	101.6%

MID MANAGEMENT

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Cecil O. Hensley

Division 2:
Michael L. Serpa

Division 3:
Tom Van Groningen (2009 Board President)

Division 4:
Paul Warda

Division 5:
John Kidd (2009 Board Vice President)

Secretary to the Board:
Pat Caldwell-Mills

Staff

General Manager:
Allen Short

Assistant General Managers

Electric Resources:
Roger VanHoy

Finance
Lou Hampel

Transmission & Distribution
Tom Kimball

Water Operations
Walter Ward

Managers

Human Resources:
Irma Perrone

Information Technology:
Pat Wheeler

General Counsel:
Tim O'Laughlin

Advisors

Government Relations

Advisors:
The Gualco Group, Inc., Sacramento
The Ferguson Group, Llc, Washington, D.C.

Trustee
The Bank Of New York Trust Company, N.A., San Francisco

Independent Accountants:
Baker Tilly Virchow Krause, Llp, Madison, Wisconsin

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Orrick, Herrington & Sutcliffe, San Francisco

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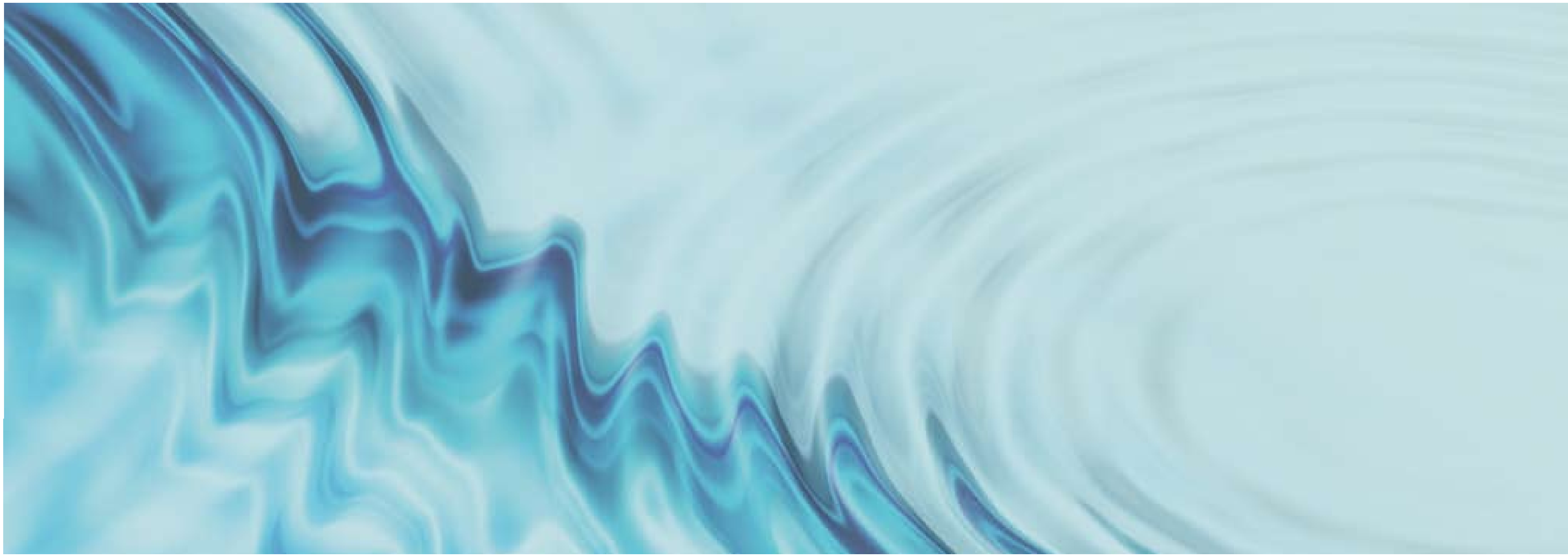

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