# *City of Seattle—*
# *City Light Department*

*Enterprise Fund of the City of Seattle*

*Financial Statements as of and for the*
*Years Ended December 31, 2007 and 2006,*
*Required Supplementary Information, and*
*Independent Auditors' Report*

# CITY OF SEATTLE—CITY LIGHT DEPARTMENT

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## INDEPENDENT AUDITORS' REPORT

Energy and Technology Committee
City of Seattle—City Light Department
Seattle, Washington

We have audited the accompanying balance sheets of the City of Seattle—City Light Department (the "Department") as of December 31, 2007 and 2006, and the related statements of revenues, expenses, and changes in equity and cash flows for the years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on the 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 1 to the financial statements, the financial statements referred to above present only the Department and are not intended to present fairly the financial position and results of operations of the City of Seattle, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of December 31, 2007, and 2006, and the changes in its equity 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 8, the Department adopted the provision of Governmental Accounting Standards Board Opinion 45 - Accounting and Financial Reporting by Employers for Post-Employment Benefits other than Pensions, effective January 1 2007.



**Virchow, Krause & Company, LLP**

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Energy and Technology Committee
City of Seattle—City Light Department

The management's discussion and analysis on pages 3 through 17 is not a required part of the basic 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.

Virchow, Krause & Company, LLP

Madison, Wisconsin
May 6, 2008

# CITY OF SEATTLE—CITY LIGHT DEPARTMENT

## MANAGEMENT'S DISCUSSION AND ANALYSIS
## DECEMBER 31, 2007 AND 2006

The following discussion and analysis of the financial performance of the City of Seattle—City Light Department (the "Department") provides a summary of the financial activities for the years ended December 31, 2007 and 2006. This discussion and analysis should be read in combination with the Department's financial statements, which immediately follow this section.

### ORGANIZATION

The Department is the public electric utility of the City of Seattle (the "City"). As an enterprise fund of the City, the Department owns and operates certain generating, transmission, and distribution facilities and supplies electricity to approximately 385,000 customers. The Department also supplies electrical energy to other City agencies at rates prescribed by City ordinances.

### OVERVIEW OF THE FINANCIAL STATEMENTS

The Department's accounting records are maintained in accordance with generally accepted accounting principles for proprietary funds 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 (FASB). The Department's accounting records follow the Uniform System of Accounts for Public Licensees prescribed by the Federal Energy Regulatory Commission (FERC).

This discussion and analysis is intended to serve as an introduction to the Department's basic financial statements, which are comprised of the financial statements and the notes to the financial statements. The Department's financial statements include the following:

***Balance Sheets, Statements of Revenues, Expenses, and Changes in Equity, and Statements of Cash Flows***—The basic financial statements provide an indication of the Department's financial health. The balance sheets include all of the Department's assets and liabilities, using the accrual basis of accounting, as well as an indication about which assets can be utilized for general purposes, and which assets are restricted as a result of bond covenants and other commitments. The statements of revenues, expenses, and changes in equity report all of the revenues and expenses during the time periods indicated. The statements of cash flows report the cash provided and used by operating activities, as well as other cash sources such as investment income and cash payments for bond principal and capital additions and betterments.

***Notes to the Financial Statements***—The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

## CONDENSED BALANCE SHEETS

| | December 31 | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| Assets: | | | |
| Utility plant—net | $1,591,294,242 | $1,516,974,608 | $1,458,734,681 |
| Capitalized purchased power commitment | 4,749,025 | 15,401,778 | 25,891,406 |
| Restricted assets | 31,109,383 | 31,502,946 | 35,815,079 |
| Current assets | 247,762,839 | 304,195,545 | 296,900,130 |
| Other assets | 295,096,371 | 263,441,612 | 239,406,075 |
| Total assets | $2,170,011,860 | $2,131,516,489 | $2,056,747,371 |
| Liabilities: | | | |
| Long-term debt | $1,263,273,902 | $1,332,589,712 | $1,401,815,402 |
| Noncurrent liabilities | 25,258,885 | 26,465,776 | 39,184,724 |
| Current liabilities | 185,237,520 | 185,799,064 | 193,070,831 |
| Deferred credits | 35,170,995 | 39,101,262 | 36,878,664 |
| Total liabilities | 1,508,941,302 | 1,583,955,814 | 1,670,949,621 |
| Equity: | | | |
| Invested in capital assets—net of related debt | 450,344,232 | 287,596,746 | 145,488,991 |
| Restricted: | 28,091,252 | 28,014,139 | 32,287,208 |
| Unrestricted | 182,635,074 | 231,949,790 | 208,021,551 |
| Total equity | 661,070,558 | 547,560,675 | 385,797,750 |
| Total liabilities and equity | $2,170,011,860 | $2,131,516,489 | $2,056,747,371 |

## ASSETS

***Utility Plant - Net***

***2007 Compared to 2006***

Utility Plant Assets net of accumulated depreciation increased $74.3 million to $1,591.3 million for 2007. The increase consisted of the following:

- Additions and replacements in 2007 to *Utility plant-in-service net of retirements and adjustments* totaled $121.6 million including:

  – a $10.9 million increase in *Hydroelectric production plant* including $5.2 million for the Ross Unit 43 generator and air circuit breaker; $1.5 million for the elevator, security system and governor control upgrade and installation of fall protection at Boundary Powerhouse; $0.9 million for the installation of irrigation system and backflow device at Newhalem; $0.8 million for replacement of generator Unit 24 transformer at Gorge Powerhouse; and $0.4 million for the improvement of Vista House road at Boundary; $0.3 million for the improvement of access road at Ross; $0.3 million for the purchases of equipment; $0.6 million for other Hydroelectric plant assets;

- a $5.6 million increase in *Transmission plant* including $2.6 million for replacement of breakers and other station equipment; $0.8 million for replacement of relays at University-Broad and Canal-Broad transmission lines; $1.2 million in transmission towers; and $0.2 million for transmission lines; $0.5 million for construction of road for the Bothell-Maple Valley transmission lines; $0.3 million for other Transmission plant assets;

- a $92.0 million increase in *Distribution plant* including $1.6 million in substation equipment; $10.7 million for poles; $7.3 million for overhead conductors for capacity additions and relocations; $17.9 million for underground conduit including $4.8 million for Shoreline undergrounding and $2.4 million for Laurelhurst 26-kV conversion; $10.2 million for network underground conduit including $4.4 million for South Lake Union Streetcar project; $7.7 million for underground conductors; $10.4 million for network underground conductors; $4.8 million for meters including automated meter readers; $8.3 million for transformers; $8.7 million for overhead, underground, and network services; and $3.1 million for streetlights including $1.1 million for the streetlights at the Westlake area;

- a $13.2 million increase in *General plant* assets including $7.6 million for purchases of vehicles and equipment; $1.6 million for system developments and purchases of computer equipment; $2.8 million for communication equipment; $1.2 million for structure improvement including construction of the visitor center in Seattle Municipal Tower;

These additions to utility plant-in-service were offset by a corresponding increase in *Accumulated depreciation* of $65.1 million which along with an increase in *Construction work-in-progress* of $17.8 million contributed $74.3 million to the net increase in Utility Plant-in-service.

- In addition, *Nonoperating property net of accumulated depreciation* decreased by a small amount, $20 thousand due to a decrease of $0.5 million in Utility Plant for Future Use for reclassification of a Network vault to Utility Plant-in-service and offsetting increases of $0.3 million in the 1% for Art inventory and $0.1 million for land purchase for future use for the remediation of the contaminated sediments in the lower Duwamish Waterway.

- *Land and land rights* increased $1.2 million due to the land purchases at Skagit, amounting to $0.9 million, for the wildlife habitat development projects and a $0.3 million increase in Land Easements for Distribution plant assets.

More information on the Department's capital assets can be found in Note 2 of the accompanying financial statements.

***2006 Compared to 2005***

Utility Plant Assets net of accumulated depreciation increased $58.2 million to $1,517.0 million for 2006. The increase consisted of the following:

- Additions and replacements in 2006 to *Utility plant-in-service net of retirements and adjustments* totaled $128.8 million including:

  - a $16.4 million increase in *Hydroelectric production plant* including $2.1 million for the North Cascades Environmental Learning Center; $8.6 million for turbine overhaul, transformer bank replacement and electrical system upgrade at Gorge; $3.6 million for the governor control, intake gate rock guard and network control system upgrade at Boundary; $1.2 million for electrical system upgrade and generator air circuit breaker at Ross; and $0.8 million for the spill gate control system installation at Diablo;

– a $9.1 million increase in *Transmission plant* including $4.0 million for station equipment replacement; $3.4 million in transmission towers; and $1.7 million for transmission lines;

– a $92.5 million increase in *Distribution plant* including $4.7 million in substation structure and equipment; $8.8 million for poles; $6.3 million for overhead conductors for capacity additions and relocations; $7.2 million for underground conduit; $2.9 million for network underground conduit; $12.6 million for underground conductors; $9.9 million for network underground conductors and $2.9 million for meters; $7.7 million for transformers; and $9.7 million due to overhead services, underground services, network underground services; $1.2 million for streetlights; and a reclassification from Utility plant held for future use to Utility plant-in-service of $18.8 million for the ductbanks and vaults installed for the undergrounding distribution system along Martin Luther King Way South related to the Sound Transit light rail project;

– a $10.8 million increase in *General plant* assets as a result of the addition of $3.3 million for the customer billing system enhancement; other system developments and purchases of computer equipment amounting to $3.4 million; $1.4 million for communication equipment; $2.0 million for transportation equipment including passenger cars; and $0.7 million for other general plant assets;

These additions to utility plant-in-service were offset by a corresponding increase in *Accumulated depreciation* of $62.4 million which along with an increase in *Construction work-in-progress* of $9.5 million contributed $75.8 million to the net increase in Utility plant-in-service.

- In addition, *Nonoperating property net of accumulated depreciation* decreased $16.2 million due to the reclassification to utility plant-in-service of $18.8 million for the ductbanks and vaults installed for the underground distribution system along Martin Luther King Way South related to the Sound Transit light rail project and a downward adjustment of $0.3 million for the 1% for Art inventory. These decreases were offset by the $2.5 million reclassification of the Interbay substation as Electrical Plant Held for Future Use; and

- *Land and land rights* decreased $1.4 million due primarily to the reclassification of $1.8 million for the Interbay substation land to Nonoperating property. This decrease is offset by a $0.4 million net increase from the sale and acquisition of land for Hydraulic and Distribution plant sites.

### *Restricted Assets*

#### *2007 Compared to 2006*

Restricted assets decreased by $.4 million to $31.1 million in 2007. Retainage deposits decreased in total by $1.3 million for contractor completed projects during the year. These deposits were offset by an increase in customer advance payments received for customer electrical construction projects that will be scheduled for completion in the amount of $.8 million. Other decreases in the amount of $.1 million during the normal course of operations accounted for the balance.

The significant component of restricted assets remained the $25.0 million Contingency Reserve Account established in 2005. The Contingency Reserve Account is restricted for extraordinary costs associated with the operation of the electric system. Other items within restricted assets were $3.0 million for the debt service account, $2.1 million for customer prepayments, and $1.0 million for vendor retainage, escrow deposits, and other.

#### *2006 Compared to 2005*

Restricted assets decreased by $4.3 million to $31.5 million in 2006. The decrease was due primarily to the elimination of the $3.8 million in restricted cash balance at the end of 2005 that was available to pay streetlight refund claims. All remaining claims were paid in 2006 and the $3.5 million residual balance was transferred to operating cash. The Contingency Reserve Account in the amount of $25.0 million established in 2005 accounts for the majority of restricted assets. In May 2005, the Seattle City Council passed Ordinance No. 121812 which authorized the purchase of a surety bond to meet the total reserve account requirements for the Department’s first-lien bonds and eliminated the need for the previously held bond reserve account. Other items within restricted assets were $2.9 million for the debt service account, and $3.6 million for vendor retainage, escrow deposits, and other.

### *Current Assets*

#### *2007 Compared to 2006*

Current assets decreased by $56.4 million to $247.8 million in 2007. *Operating cash* decreased $39.4 million to $87.7 million. One of the main reasons for the lower cash balance was the effect of the average system rate decrease of 8.4% implemented at the beginning of 2007. Other causes for the lower cash balance were due to higher operating costs, ongoing construction activity related to the Sound Transit light rail project, and increased construction for underground infrastructure projects in Shoreline, Aurora, and Burien; suburban areas or jurisdictions within the Department’s service area.

Total *Accounts receivable* decreased $9.0 million to $71.7 million in 2007. Receivables for *electric sales* at $41.2 million net of the allowance decreased slightly by $.2 million from 2006. During 2007, $14.6 million of electric accounts in arrears were written-off in the electric billing system. A corresponding adjustment was made to the allowance for electric accounts. Also in 2007, the $7.7 million accrual for the Nucor billing for an Extraordinary Power Cost Adjustment (EPCA) allowed for in the most recent replacement interruptibility contracts was settled for nearly $2.0 million. The unpaid balance of $5.8 million for the Nucor receivable was written-off and the related allowance was adjusted accordingly. Accounts receivable for *wholesale power sales* net of allowance decreased $2.6 million because of somewhat lower sales for December 2007 compared to December 2006. *Grants receivables* for capital grants decreased $5.4 million as funds were received principally for the Sound Transit light rail project. However, $3.3 million of grants receivable recorded at the end of 2006 was reversed in 2007 as a result of discussions initiated in 2007 and pending agreement between Sound Transit and the Department regarding responsibility for cost overruns. *Other sundry receivables* decreased $.8 million net from 2006 during the normal course of operations. More information on the Department's various accounts receivable balances can be found in Note 4 of the accompanying financial statements.

Other current assets decreased $8.0 million in 2007 from 2006. *Unbilled revenues* decreased $5.0 million due to the lower system rate decrease effective for 2007 and *Energy contracts* or short-term forward power contracts valued at fair market decreased $5.8 million due to a combination of less forward power contracts outstanding and smaller variance between power contractual prices and forward market prices at the end of 2007 compared to 2006. Inventory for *Materials and supplies* increased $2.8 million from 2006.

***2006 Compared to 2005***

Current assets increased $7.3 million to $304.2 million in 2006. *Operating cash* decreased $14.7 million to $127.1 million due primarily to increased construction activity related to the Sound Transit light rail, Shoreline infrastructure, and other distribution projects.

Total *Accounts receivable* increased $10.8 million to $80.7 million in 2006. Receivables for *electric sales* increased only $0.6 million net of the allowance. Included in these receivables was $7.7 million billed to Nucor for an Extraordinary Power Cost Adjustment which was offset by an increase of $6.7 million in the allowance because of uncertainty surrounding the collectibility of this billing. Active accounts receivables in arrears over 90 days continued to decline with the continued focus on collection efforts in this area. Accounts receivable for *wholesale power sales* increased a net $2.4 million on account of higher sales for December 2006 compared to December 2005, and recovery of monies from bankruptcy distributions during the year, which reduced the allowance for wholesale power sales by $1.2 million. Related to power sales, valuation of the receivable for *exchanged energy* increased $1.9 million as a result of valuing this transaction at market in compliance with a new accounting standard. *Interfund receivables* decreased $1.7 million. *Due from other governments* increased $6.2 million primarily for grants from Sound Transit as construction continued. *Standard connection* receivables were higher by $2.5 million. *Miscellaneous sundry receivables* decreased by $1.1 million from 2005 during the normal course of operations.

Other current assets increased $11.2 million in 2006 from 2005. Increases included $3.8 million for unbilled revenues due to the colder weather in December 2006; $4.8 million for short-term forward power contracts valued at market with a favorable position at year end; and $2.5 million for higher inventory.

***Other Assets***

***2007 Compared to 2006***

Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation*, provides for the deferral of certain utility costs and related recognition in future years as the costs are recovered through future rates. Deferred costs are authorized by resolutions passed by the Seattle City Council and include capitalized energy management services, deferred power costs, deferral of payments to the Province of British Columbia under the High Ross Agreement, and other deferred charges.

Deferred assets increased $31.6 million to $295.1 million in 2007. The increase includes the following:

- $3.5 million in *deferred conservation costs, net*. Conservation measures, funded in part by the BPA in exchange for decrements to Block power, are currently deferred and amortized over a 20-year period.

- $12.1 million in *capitalized relicensing costs* incurred primarily in preparation for the application to FERC to relicense the Boundary hydro generation facility; the Department intends to submit an application for a new license by October 2009.

- $8.9 million *annual deferral of payment due* to B. C. Hydro for the High Ross Agreement.

- $17.8 million increase in long-term receivables for infrastructure improvements in the Department service areas of Shoreline, Aurora, and Burien. These improvements were recorded as contributions in aid of construction and will be repaid by the respective electric customers within these jurisdictions through electric rates over 25 years commencing in January 2008 for the Shoreline improvements. Billings will be made to Aurora beginning in June 2008 and Burien billings are anticipated in the latter part of 2008.

- $10.9 million net decrease for *Bonneville Slice contract true-up payment.* The Department is subject to true-up payments for the Department's fixed 4.6676% of actual output and costs of Bonneville Slice power through September 30, 2011. In December 2006, Bonneville billed the Department $10.9 million, which was recorded as an accounts payable and deferred asset in December 2006 to be paid and expensed in 2007. In December 2007, Bonneville issued a credit within the Bonneville monthly billing to the Department in the amount of $1.6 million for the 2007 true-up cost adjustment with payment of the Bonneville bill due in January 2008. The true-up credit was recorded as a deferred credit in December 2007 and will be realized in 2008.

- $.3 million net decrease in other deferred charges in the normal course of operations.

Details for Other deferred charges and assets, net, are provided in Note 11 of the accompanying financial statements.

***2006 Compared to 2005***

Deferred assets increased $24.0 million to $263.4 million in 2006. The increase includes the following:

- $7.4 million in *deferred conservation costs, net.*

- $4.7 million in *capitalized relicensing costs* incurred primarily in preparation for the application to FERC to relicense the Boundary hydro generation facility.

- $8.9 million *annual deferral of payment due* to B. C. Hydro for the High Ross Agreement.

- $3.5 million increase in long-term receivables, principally for the receivable from the City of Shoreline for infrastructure improvements, recorded as contributions in aid of construction for 2006, that will be repaid by Shoreline electric customers through rates over 25 years commencing in January 2008.

- $1.8 million net increase for *Bonneville Slice contract true-up payment.* The Department is subject to true-up payments for the Department's fixed 4.6676% of actual output and costs of Bonneville Slice power through September 30, 2011. In December 2005, Bonneville billed the Department $9.1 million for the 2005 true-up cost adjustment with payment due in January 2006. In December 2006, Bonneville billed the Department $10.9 million, which was recorded as an accounts payable and deferred asset in December 2006 to be paid and expensed in 2007.

- $1.3 million decrease due to *unrealized losses* from fair market valuations of short-term forward power contracts being incurred at the end of 2005 which did not recur at the end of 2006. The Department had a net overall favorable position of $6.5 million for short-term forward contracts at the end of 2006, recorded in deferred credits.

## LIABILITIES

### *Long-Term Debt*

#### *2007 Compared to 2006*

Long-term debt decreased by $69.3 million to $1,263.3 million during 2007. No additional revenue bonds were issued in 2007. The Department continued making progress on debt reduction with a goal of a debt to capitalization ratio of 60.0% by 2010. The debt to capitalization ratio at the end of 2007 was 67.0%, a reduction from the 2006 ratio of 72.0%. The long-term note payable to Sound Transit for the new light rail line in progress was paid in full during 2007. Installment payments for the note payable with the State of Washington, negotiated in 2006 for the purchase of Microsoft Office 2003, were made on schedule. The principal amount paid during 2007 was $270.2 thousand leaving a balance of $284.9 thousand at the end of 2007. Net revenues available to pay debt service were equal to 1.88 times principal and interest on all bonds for 2007.

During 2007, Moody's Investors Service affirmed the credit rating of Aa3 for the Department's revenue bonds. Moody's also changed the outlook from stable to positive noting the improved financial trend and stronger focus on resource planning. Standard and Poor's credit rating was also affirmed at A+.

Note 6 of the accompanying financial statements provides additional information related to the Department's long-term debt.

#### *2006 Compared to 2005*

Long-term debt decreased by $69.2 million to $1,332.6 million during 2006. There were no new revenue bonds issued during 2006 as the focus continued to be on debt reduction with a goal of a debt to capitalization ratio of 60.0% by 2010. The debt to capitalization ratio at the end of 2006 was 72.0%. The long-term note payable to Sound Transit for the new light rail line in progress was repaid ahead of schedule during the year leaving a balance of $4.0 million at the end of 2006. A new note payable was negotiated with the State of Washington during 2006 for the purchase of Microsoft Office 2003, which was installed on the local area network. The balance of this note at the end of the year was $0.6 million. After payment of cash operating expenses, net revenues available to pay debt service were equal to 2.37 times principal and interest on all bonds.

### *Environmental Liabilities*

Environmental liabilities totaled $17.6 million, $10.8 million and $9.1 million at December 31, 2007, 2006 and 2005, respectively. The liabilities are primarily attributable to the estimated cost of remediating contaminated sediments in the lower Duwamish Waterway, which was designated a federal Superfund site by the Environmental Protection Agency in 2001. The Department is considered a potentially responsible party for contamination in the Duwamish River due to land ownership or use of property located along the river.

## RESULTS OF OPERATIONS

While the balance sheets show changes in assets, liabilities, and fund equity, the statements of revenues, expenses, and changes in fund equity provide insight into the source of these changes.

***Condensed Revenues and Expenses***

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| Operating revenues | $ 832,524,784 | $ 831,810,233 | $ 748,552,561 |
| Nonoperating revenues | 10,747,418 | 11,947,367 | 5,417,494 |
| Total revenues | 843,272,202 | 843,757,600 | 753,970,055 |
| Operating expenses | 702,176,110 | 642,041,903 | 624,592,061 |
| Nonoperating expenses | 73,698,789 | 71,780,961 | 73,646,463 |
| Total expenses | 775,874,899 | 713,822,864 | 698,238,524 |
| Capital contributions | 37,736,620 | 21,538,722 | 18,944,222 |
| Grants | 8,375,960 | 10,289,467 | 7,234,823 |
| Net income | $ 113,509,883 | $ 161,762,925 | $ 81,910,576 |

## SUMMARY

***2007 Compared to 2006***

Net income for 2007 at $113.5 million was another robust year, even though it was a decrease of $48.3 million or 33%, from last year's record net income. $40.7 million of the decrease was due in large part to the overall 2007 system rate decrease implemented in January 2007. Within operating expenses, administrative and general costs were higher by $17.7 million due in part to higher costs in the areas of pensions, benefits, rents, and environmental pertaining to clean-up of the Duwamish superfund sites. Other power costs increased by nearly $1.0 million. Offsetting the lower revenues and higher operating expenses was an increase in *Other deductions, net* by $11.1 million from 2006, attributable mainly to higher capital fees recorded for underground infrastructure improvements to suburban areas within the Department's service area.

***2006 Compared to 2005***

Net income for 2006 was a record $161.8 million, an increase of $79.9 million for the year, and nearly twice the $81.9 million net income earned in 2005. As a result of improved precipitation in the Northwest region, net revenue from short-term wholesale power sales was $128.9 million compared to $87.4 million in 2005, an increase of $41.5 million. Operating revenues, outside of short-term wholesale power sales, increased $56.7 million. The increase in operating revenues was offset by a $32.3 million increase in operating expenses other than the cost of wholesale purchases. Also contributing to the higher net income in 2006 were higher non-operating revenues of $6.6 million, higher capital contributions and fees of $5.6 million, and slightly lower non-operating expenses of $1.8 million over 2005.

**REVENUES**

***2007 Compared to 2006***

***Retail—***Revenues from sales of energy to retail customers decreased significantly by $40.7 million to $542.4 million in 2007. An average system rate decrease of 8.4% was in effect at the beginning of the year and hence, accounting for the decrease from 2006 revenues. Even with the lower rates, *residential retail* revenues only decreased by $1.58 million or .8% from 2006 in part due to billed consumption to *residential retail* customers being higher by 2.4%. *Nonresidential revenues* experienced the largest decrease in retail revenues declining $30.4 million or 8.0%, with megawatt hours billed increasing slightly by 1.9%. Also contributing to the lower *nonresidential revenues* was the fact that there was no Nucor ECPA adjustment in 2007 compared to the adjustment of $7.7 million for 2006. The net *unbilled revenue* adjustment for 2007 was an unfavorable variance of $8.7 million from 2006, also attributable essentially to the lower rates in effect.

***Wholesale—****Sales* of surplus power in the wholesale market yielded $161.1 million in revenue in 2007, a decrease of $15.1 million from 2006. There was less overall power generation from the Department's facilities, especially at the Boundary plant that experienced lower stream flows than normal because of lower precipitation in the eastern Washington region. Sales of energy were lower by 16.6 % to 3,822,098 MWh for 2007 compared to 4,580,325 MWh in 2006. The lower sales of energy were offset in part by a 6.0 % increase in average year-to-date power sales price of $47.72 per MWh in 2007 compared to $45.03 per MWh in 2006.

*Purchases* of wholesale energy decreased by $13.9 million in 2007. Energy purchased in 2007 was 947,937 MWh, a decrease of 386,042 MWh or 28.9% from 2006. Average year-to-date power purchase prices decreased to $47.56 per MWh in 2007 from $49.54 per MWh in 2006.

Energy sales were 4.03 times the amount of energy purchased during 2007. The higher ratio of sales to purchases along with higher average power prices during 2007 resulted in net revenues totaling $127.7 million for 2007, an incremental decrease of $1.2 million or .9% from net revenues of $128.9 million in 2006. Net revenues include the effect of recording long-term purchased power bookouts (net financial settlement for power without physical delivery) that are a result of executing short-term wholesale power transactions. These bookouts totaled $9.6 million for 2007 and $11.3 million for 2006. The bookouts had the effect of lowering net revenues from wholesale energy sales for both years. Similarly, long-term power purchases also declined by equal amounts with no net effect to net income. This change was first implemented in 2006.

***Other Power-Related—***This category of revenue consists of other power-related transactions and products sold by the Department such as revenue from Bonneville conservation programs, sales of reserve capacity, wheeling, power exchanges, and other. Revenue in this category increased $56.6 million to $109.3 million in 2007. Effective in 2006, *power exchanges* derived from certain power contracts were valued at fair market in accordance with a new accounting standard. During 2007, valuations for power exchanges increased considerably as the Department expanded into additional ancillary services that included power exchange components. Additional power contracts with power exchange valuations at fair market totaled $22.0 million. Of this amount, $20.5 million had a corresponding purchased power exchange with no effect on net income. Wholesale power basis revenues (simultaneous sale/purchase of energy at one location and corresponding energy sale/purchase at another location) increased $26.6 million from 2006, as more of these transactions were executed, with valuation at full contractual prices, compared to 2006. As a side note, net revenues from basis transactions increased only $1.6 million from 2006. The balance of the $8.0 million net increase in *other power-related revenues* was due primarily to receiving contractual payments from the sale of energy generated at the Lucky Peak Project that also constituted a power exchange element.

***Other*****—**Revenues from a variety of other sources remained unchanged from 2006 at $19.7 million. In 2007, there was an increase of $3.2 million in non-utility operations for reimbursement of environmental mitigation costs from the City of Seattle in accordance with a court order judgment and $1.2 million for insurance recoveries from previous claims. In 2006, $3.5 million was realized for the balance of residual cash for unclaimed streetlight refunds by customers, as allowed by the streetlight court settlement and with no activity in this area in 2007. The remaining activity included increases and decreases during the normal course of operations.

***2006 Compared to 2005***

***Retail*****—**Revenues from sales of energy to retail customers increased by $20.6 million to $583.1 million in 2006. There were no rate adjustments during 2006 and accordingly, the downward Bonneville pass-through rate adjustment of November 2005 was still in effect. Energy consumption billed to *residential retail* customers was higher by 2.7% which accounted in part for the increase in revenues of $2.6 million compared to 2005. *Nonresidential revenues* increased by $13.1 million or 3.6%. Nonresidential consumption was up 2.8% over 2005. At the end of 2006, Nucor was billed $7.7 million for the EPAC computed in accordance with the recent interruptible power contracts that expired on January 1, 2007, with the implementation of new system rates for the Department. The net *unbilled revenue* adjustment of $3.8 million for 2006 resulted in a favorable swing of $4.8 million between years on account of colder weather during the latter part of 2006.

***Wholesale*****—***Sales* of surplus power in the wholesale market generated $176.2 million in revenue in 2006, an increase of nearly $27.0 million from 2005. Improved water conditions during 2006 contributed positively to the sales of surplus energy sold on the wholesale market. Sales of energy increased by 60.9% to 4,580,352 MWh for 2006 compared to 2,846,599 MWh in 2005. The higher sales of energy were offset in part by a 16.5% decrease in average year-to-date power sales price of $45.03 per MWh in 2006 compared to $53.93 per MWh in 2005.

*Purchases* of wholesale energy decreased by $14.9 million in 2006 as a result of more power generated from improved precipitation in the region used for managing system load and meeting contractual obligations. Energy purchased in 2006 was 1,333,979 MWh, an increase of 300 MWh or 29.0% from 2005. Average year-to-date power purchase prices decreased to $49.54 per MWh in 2006 from $63.89 per MWh in 2005.

The net effect of higher energy sales at 3.43 times the amount of energy purchased combined with the impact of lower average power prices produced net revenues totaling $128.9 million for 2006, an increase of $41.5 million or 47.4% from net revenues of $87.4 million in 2005. In addition, recording of long-term purchased power bookouts (net financial settlement for power without physical delivery) in the amount of $11.3 million attributable to short-term wholesale power sales had the effect of lowering net revenues from wholesale energy sales for 2006. Conversely, long-term power purchases also declined by the same amount and consequently, there was no net effect to net income. This change was implemented in 2006 because of improved availability of power transaction data and to comply with accounting standards.

***Other Power-Related*****—**Revenue in this category increased $29.4 million to $52.7 million in 2006. Effective in 2006, *power exchanges* from certain power transactions were valued at fair market in accordance with a new accounting standard. These power exchanges totaled $22.0 million. Of this amount, $20.5 million had a corresponding purchased power exchange with no effect on net income. The balance of the $7.4 million net increase in *other power-related revenues* was due primarily to receiving a full year of power revenues from a contract with Grant County Public Utility District executed in November 2005, increasing revenues by $7.1 million.

***Other—***Revenues from a variety of other sources increased $6.7 million to $19.7 million in 2006 from $13.0 million in 2005. $3.2 million of the increase was for the balance of residual cash for unclaimed streetlight refunds by customers, as allowed by the streetlight court settlement. In 2004, a Washington State Supreme Court decision required the City of Seattle reimburse the Department for $23.9 million in streetlight costs that would have been billed to the City from December 29, 1999 to November 13, 2003. The Department was required to refund to its customers in the City the amount collected for streetlight costs over that period and to refund to its customers in the city of Tukwila the amount collected from December 24, 1999 through April 30, 2003. The balance in increased revenues in the amount of $3.5 million was from other operations including $2.6 million for salvage sales of surplus wire.

## EXPENSES

### *2007 Compared to 2006*

Total operating expenses were $702.1 million, an increase of $60.1 million from $642.0 million in 2006.

*Power related expenses* totaled $400.6 million, a $45.9 million increase from 2006. *Bonneville power expenses* were higher by $21.1 million. Bonneville power contractual costs increased $13.6 million primarily for the block or fixed portion of the contract as a result of contractual changes that significantly increased power purchases for the Department over the remaining life of the contract effective in October 2006. Annual true-up for the slice or variable portion of the contract was a net increase of $7.5 million from 2006. The annual true-up for 2006 expensed in 2007 resulted in a net increase of $2.0 million for 2007. In addition, the Department benefited in 2006 from a one-time settlement with Bonneville in favor of the slice participants for the first five years of slice true-ups in the amount of $5.4 million.

*Power related wholesale purchases* increased a total of $45.3 million from 2006, of which $20.5 million was for recording additional power exchanges at fair value corresponding to the related power exchange revenues noted above with no effect to net income. The balance of the increase of $24.8 million from 2006 related in part to wholesale power basis transactions valued at contractual prices, also previously mentioned for associated basis revenues. In addition, fair market valuations were assigned to bookouts for basis transactions beginning in 2007 as system enhancements were developed that produced improved data.

*Long-term purchased power –other* and *short-term power expenses* decreased a combined $25.1 million from 2006. Decreased purchases of short-term wholesale energy accounted for nearly $14.0 million, as discussed above under *Wholesale* revenues. *Long-term purchased power – other* declined $11.1 million from 2006, primarily due to the purchase power contract with the City of Klamath Falls that expired at the end of July 2006.

The balance net increase of $4.6 million in *power related expenses* was basically the effect of higher fair market valuations of NCPA exchanged power delivered during 2007 ($2.8 million) and a lower valuation of long-term purchased power bookouts resulting form short-term wholesale transactions ($1.7 million).

*Non-power operating expenses* increased $15.8 million to $165.3 million in 2007 from $149.5 million in 2006. Distribution expenses increased $3.5 million due in part to higher labor expenses incurred for a variety of projects, including work related to the December 2006 Storm. Administrative and general costs incurred grew by $17.7 million totaling $66.7 million in 2007 due in large part to higher costs for administrative systems enhancements, pensions, benefits, rents, and environmental clean-up of various

Duwamish superfund sites. Offsetting the increases were *Customer Service* expenses declining by $6.8 million from 2006; the majority due to the one-time Nucor EPAC bad debt expense of $6.7 million incurred in 2006. Finally, higher amortization of deferred conservation costs in the amount of $1.4 million made up the balance of the increase for this category of expenses.

*Taxes* decreased $4.4 million from 2006 on account of the lower revenue base. *Depreciation expense* increased $2.8 million in 2007, generally the result of new plant additions.

***2006 Compared to 2005***

Total operating expenses were $642.0 million, an increase of $17.4 million from $624.6 million in 2005.

*Power related expenses* totaled $354.7 million, a $2.1 million increase from 2005. Bonneville power expenses were higher by $23.2 million. Bonneville power contractual costs increased $21.8 million primarily for the block or fixed portion of the contract as a result of contractual changes that significantly increased power purchases for the Department over the remaining life of the contract effective in October 2006. Annual true-up for the slice or variable portion of the contract was a net increase of $1.4 million from 2005. The Department benefited from settlement with Bonneville in favor of the slice participants for the first five years of slice true-ups in the amount of $5.4 million.

Power related wholesale purchases increased a total of $22.3 million from 2005, of which $20.5 million was for recording certain power exchanges at fair value corresponding to the related power exchange revenues noted above with no effect to net income.

Long-term purchased power –other and short-term power expenses decreased a combined $53.0 million from 2005. Decreased purchases of short term wholesale energy accounted for $14.9 million, as discussed above under Wholesale revenues. Long-term purchased power – other declined $38.1 million from 2005. The purchase power contract with the City of Klamath Falls expired at the end of July 2006 accounting for $31.8 million. In addition, $11.3 million of lower long term purchased power costs pertain to recording bookouts assigned to short-term sales of surplus energy effective for 2006 as noted in Wholesale revenues above. The balance net increase of $5.0 million is the result of higher costs incurred for several other long term purchase power contracts.

*Non-power operating expenses* increased $12.7 million to $149.5 million in 2006 from $136.8 million in 2005. Distribution expenses included higher storm costs, specifically $3.2 million for the December 14 Storm. Incorporated within customer service expenses was a $6.7 million increase in bad debt expense tied directly to the revenue recorded for the Nucor EPAC due to uncertainty surrounding collectibility of the EPAC. Risk management liabilities were higher by $1.0 million during 2006 due in part to higher judgment claims and ongoing remediation costs incurred for the Duwamish superfund site. Employee benefit expenses also increased by $1.8 million from 2005 mainly due to higher health care costs.

## OTHER NONOPERATING INCOME AND EXPENSE

***2007 Compared to 2006***

***Nonoperating Revenues (Expenses)***—Nonoperating (expenses) increased $11.1 million to $16.9 million in 2007 from $28.0 million in 2006 due to the following:

<u>*Nonoperating income*</u> decreased $6.4 million to $5.6 million from 2006. *Investment income* increased incrementally $.2 million to $10.2 million from 2006. Other deductions were $4.6 million in 2007, a $6.6 million unfavorable variance from 2006. A significant portion of the variance is due to reversal of costs

that had been recorded as grant revenues in 2006. $3.3 million of grants from Sound Transit was recorded as other deductions in 2007 because of pending discussion and agreement between Sound Transit and the Department regarding responsibility for cost overruns. Additionally, $1.2 million of costs from the Spokane Bridge expansion project in Seattle were determined to be unrecoverable. The balance of $2.1 million was mostly the result of minimal property sales in 2007 compared to 2006.

Nonoperating expense decreased $3.2 million from $71.8 million in 2006 to $68.6 million in 2007. The decrease is due primarily due to lower interest expense on outstanding bonds as bonds continued to be repaid and with no additional bonds issued in 2007. Interest expense for parity bonds decreased $2.8 million while interest expense for variable rate bonds remained virtually unchanged at $2.9 million.

***Fees and Grants***—Fees and grants increased by $14.3 million in 2007. The largest increase of $12.4 million was the result of completed underground infrastructure improvements for the areas of Aurora and Burien; suburban areas or jurisdictions within the Department's service territory. In 2006, infrastructure improvements were $3.7 million for Shoreline. The respective customers from these jurisdictions will pay for these improvements over a 25 year period through their electric billings commencing January 2008 for Shoreline, and later in 2008 for the other areas. In-kind contributions were also higher in 2007 by $5.3 million, of which $2.4 million was for contributions relating to a new streetcar trolley serving Seattle's north downtown area, and the balance was for on-going customer requested improvements. The balance of the increase of $3.4 million for *fees and grants* were for other projects that had increases and decreases in the normal course of operations, and included $6.0 million of federal and state grants recognized for the December 2006 storm.

***2006 Compared to 2005***

***Nonoperating Revenues (Expenses)***—Nonoperating revenues (expenses) increased $8.4 million in 2006 as a result of the following:

Nonoperating income increased $6.6 million to $12.0 million in 2006. *Investment income* was higher by $4.3 million compared to 2005 because of higher average operating cash balances during the year and because the City's cash pool portfolio was turned over to higher yielding investments. The Department's share of fair market value gains on investments in the City's cash pool was a positive swing between years of $2.6 million. Gains from the sale of surplus property and gains from bankruptcy distributions for delivered wholesale power in prior years combined added $1.8 million more in 2006 than in 2005.

Nonoperating expense decreased $1.8 million from $73.6 million in 2005 to $71.8 million in 2006. The decrease is due primarily due to lower interest expense on outstanding bonds as bonds continued to be repaid and with no new bonds issued during 2006. Interest expense for parity bonds decreased $2.5 million while interest expense for variable rate bonds increased $.8 million due to higher short-term interest rates.

***Fees and Grants—***Fees and grants increased by $5.6 million in 2006. All *capital contributions* were higher by $2.6 million for various new and ongoing projects within the Department's service area. Completed in 2006 were underground improvements to a portion of the Shoreline infrastructure totaling $3.7 million. Shoreline customers will pay for these improvements over a 25 year period through their electric billings commencing in mid-2007. In-kind contributions decreased $7.0 million primarily from Sound Transit in connection with the construction of the regional light rail system received in 2005. *Grants* during 2006 were higher by $3.0 million principally on behalf of Sound Transit construction at Tukwila.

**RISK MANAGEMENT**

The Department's exposure to market risk is managed by the Power Management Executive under the guidance of a Risk Oversight Council made up of the Chief Financial Officer, Power Supply and Environmental Affairs Officer, Director of Risk Oversight, and Power Management Executive (non-voting member). The Department engages in market transactions to meet its load obligations and to realize earnings from surplus energy resources. Except for limited intraday and interday trading to take advantage of owned hydro storage, the Department does not take market positions in anticipation of generating revenue.

With a significant portion of the Department's revenue expected from wholesale energy market sales, great emphasis is placed on the management of risks associated with this activity. Policies, procedures, and processes designed to manage, control and monitor these risks are in place. A formal front, middle, and back office structure is in place to ensure proper segregation of duties. The Risk Oversight Division performs the middle office functions which include independent reporting of market positions and energy risk management policy compliance.

The Department measures the risk in its energy portfolio on a weekly basis using a Monte Carlo model that incorporates not only price risk, but also the volumetric risk associated with its hydro-dominated power portfolio. Scenario analysis is used for stress testing.

The Department mitigates credit risk by trading only with pre-approved, qualified counterparties. The Risk Oversight Council establishes the methodology for determining the maximum credit limit available to any counterparty. The CFO is responsible for establishing the actual, limit, not to exceed the maximum.

# CITY OF SEATTLE—CITY LIGHT DEPARTMENT

## BALANCE SHEETS
## AS OF DECEMBER 31, 2007 AND 2006

| ASSETS | 2007 | 2006 |
|---|---|---|
| UTILITY PLANT—At original cost: | | |
| Plant-in-service—excluding land | $ 2,605,862,005 | $ 2,485,488,981 |
| Less accumulated depreciation | (1,174,568,383) | (1,109,485,544) |
| Total utility plant | 1,431,293,622 | 1,376,003,437 |
| Construction work-in-progress | 104,241,116 | 86,410,907 |
| Nonoperating property—net of accumulated depreciation | 4,552,932 | 4,092,665 |
| Assets held for future use | 10,155,422 | 10,636,532 |
| Land and land rights | 41,051,150 | 39,831,067 |
| Utility plant—net | 1,591,294,242 | 1,516,974,608 |
| CAPITALIZED PURCHASED POWER COMMITMENT | 4,749,025 | 15,401,778 |
| RESTRICTED ASSETS: | | |
| Contingency Reserve Account | 25,000,000 | 25,000,000 |
| Debt Service Account | 2,997,408 | 2,939,423 |
| Special deposits and other | 3,111,975 | 3,563,523 |
| Total restricted assets | 31,109,383 | 31,502,946 |
| CURRENT ASSETS: | | |
| Cash and equity in pooled investments | 87,723,933 | 127,148,120 |
| Accounts receivable, net of allowance of $6,024,068 and $23,321,762 | 71,680,393 | 80,672,388 |
| Unbilled revenues | 59,515,576 | 64,484,955 |
| Energy contracts | 854,726 | 6,680,264 |
| Materials and supplies at average cost | 26,935,722 | 24,156,843 |
| Prepayments, interest receivable, and other | 1,052,489 | 1,052,975 |
| Total current assets | 247,762,839 | 304,195,545 |
| OTHER ASSETS: | | |
| Deferred conservation costs—net | 141,583,364 | 138,077,119 |
| Capitalized relicensing costs—net | 40,916,887 | 28,852,177 |
| Deferred costs—High Ross Agreement—net | 75,815,265 | 66,941,824 |
| Other deferred charges and assets—net | 36,780,855 | 29,570,492 |
| Total other assets | 295,096,371 | 263,441,612 |
| TOTAL | $ 2,170,011,860 | $ 2,131,516,489 |

See notes to financial statements.

| | 2007 | 2006 |
|---|---|---|
| **LIABILITIES** | | |
| LONG-TERM DEBT: | | |
| Revenue bonds | $ 1,342,460,000 | $ 1,409,215,000 |
| Plus bond premium | 29,031,729 | 32,807,763 |
| Less bond discount | (480,702) | (560,841) |
| Less deferred charges on advanced refunding | (37,277,125) | (42,402,063) |
| Less revenue bonds—current portion | (70,460,000) | (66,755,000) |
| Notes payable | 284,853 | 4,511,597 |
| Less notes payable—current portion | (284,853) | (4,226,744) |
| Total long-term debt | 1,263,273,902 | 1,332,589,712 |
| NONCURRENT LIABILITIES: | | |
| Accumulated provision for injuries and damages | 19,684,951 | 12,260,522 |
| Compensated absences | 11,343,185 | 10,387,612 |
| Long-term purchased power obligation | 4,749,025 | 15,401,778 |
| Less purchased power obligation—current portion | (11,970,000) | (11,770,000) |
| Other | 1,451,724 | 185,864 |
| Total noncurrent liabilities | 25,258,885 | 26,465,776 |
| CURRENT LIABILITIES: | | |
| Accounts payable and other | 72,887,909 | 72,463,514 |
| Accrued payroll and related taxes | 8,303,782 | 8,965,594 |
| Compensated absences | 1,222,813 | 1,005,628 |
| Accrued interest | 19,444,629 | 20,421,541 |
| Notes payable—current portion | 284,853 | 4,226,731 |
| Long-term debt—current portion | 70,460,000 | 66,755,000 |
| Purchased power obligation | 11,970,000 | 11,770,000 |
| Energy contracts | 663,534 | 191,056 |
| Total current liabilities | 185,237,520 | 185,799,064 |
| DEFERRED CREDITS | 35,170,995 | 39,101,262 |
| Total liabilities | 1,508,941,302 | 1,583,955,814 |
| COMMITMENTS AND CONTINGENCIES (Note 14) | | |
| **EQUITY** | | |
| Invested in capital assets, net of related debt | 450,344,232 | 287,596,746 |
| Restricted net assets | 28,091,252 | 28,014,139 |
| Unrestricted—net | 182,635,074 | 231,949,790 |
| Total equity | 661,070,558 | 547,560,675 |
| TOTAL | $ 2,170,011,860 | $ 2,131,516,489 |

# CITY OF SEATTLE—CITY LIGHT DEPARTMENT

## STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN EQUITY
## FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

| | 2007 | 2006 |
|---|---|---|
| OPERATING REVENUES: | | |
| Retail power revenues | $ 542,363,033 | $ 583,114,102 |
| Short-term wholesale power revenues | 161,154,295 | 176,243,887 |
| Other power-related revenues | 109,305,208 | 52,720,212 |
| Other | 19,702,248 | 19,732,032 |
| Total operating revenues | 832,524,784 | 831,810,233 |
| OPERATING EXPENSES: | | |
| Long-term purchased power—Bonneville | 175,791,029 | 154,718,362 |
| Long-term purchased power—other | 44,403,554 | 55,521,124 |
| Short-term wholesale power purchases | 33,430,904 | 47,360,729 |
| Other power expenses | 76,982,940 | 30,710,604 |
| Generation | 24,973,789 | 19,563,515 |
| Transmission | 45,137,975 | 46,825,069 |
| Distribution | 53,753,779 | 50,337,958 |
| Customer service | 31,241,759 | 37,986,487 |
| Conservation | 13,557,643 | 12,216,759 |
| Administrative and general | 66,729,457 | 48,961,846 |
| City of Seattle occupation tax | 33,396,036 | 35,591,206 |
| Other taxes | 25,711,410 | 27,977,012 |
| Depreciation | 77,065,835 | 74,271,232 |
| Total operating expenses | 702,176,110 | 642,041,903 |
| NET OPERATING INCOME | 130,348,674 | 189,768,330 |
| NONOPERATING REVENUES (EXPENSES): | | |
| Investment income | 10,217,061 | 9,994,035 |
| Interest expense | (66,386,174) | (69,444,742) |
| Amortization of refunding loss | (5,124,938) | (5,441,816) |
| Amortization of bond premium | 3,776,034 | 3,966,297 |
| Amortization of bond discount and issue costs | (827,253) | (860,699) |
| Gain on sale of property | 530,357 | 2,126,043 |
| Other income (expense)—net | (5,136,458) | (172,712) |
| Total nonoperating expenses | (62,951,371) | (59,833,594) |
| NET INCOME BEFORE FEES AND GRANTS | 67,397,303 | 129,934,736 |
| FEES AND GRANTS: | | |
| Capital contributions | 37,736,620 | 21,538,722 |
| Grants | 8,375,960 | 10,289,467 |
| Total fees and grants | 46,112,580 | 31,828,189 |
| NET INCOME | 113,509,883 | 161,762,925 |
| EQUITY: | | |
| Beginning of year | 547,560,675 | 385,797,750 |
| End of year | $ 661,070,558 | $ 547,560,675 |

See notes to financial statements.

# CITY OF SEATTLE—CITY LIGHT DEPARTMENT

## STATEMENTS OF CASH FLOWS
## FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

| | 2007 | 2006 |
|---|---|---|
| OPERATING ACTIVITIES: | | |
| Cash received from customers and counterparties | $ 763,542,564 | $ 778,970,245 |
| Cash paid to suppliers, employees, and counterparties | (486,298,742) | (472,629,484) |
| Taxes paid | (59,143,482) | (62,606,379) |
| Net cash provided by operating activities | 218,100,340 | 243,734,382 |
| NONCAPITAL FINANCING ACTIVITIES: | | |
| Principal paid on State of Washington note | (269,157) | (276,494) |
| Interest paid on State of Washington note | (21,014) | (13,677) |
| Non-capital grants received | 3,894,150 | 1,471,879 |
| Gains from bankruptcy distributions | 525,233 | 681,254 |
| Bonneville receipts for conservation | 1,917,215 | 4,010,862 |
| Payment to vendors on behalf of customers for conservation augmentation | (13,693,237) | (17,647,501) |
| Net cash used in noncapital financing activities | (7,646,810) | (11,773,677) |
| CAPITAL AND RELATED FINANCING ACTIVITIES: | | |
| Principal paid on long-term debt | (66,755,000) | (63,435,000) |
| Interest paid on long-term debt | (69,859,722) | (72,597,427) |
| Proceeds from Sound Transit note | | 956,793 |
| Principal paid on Sound Transit note | (4,294,210) | (6,256,410) |
| Interest paid on Sound Transit note | (95,835) | (67,317) |
| Acquisition and construction of capital assets | (137,836,056) | (131,079,148) |
| Capital contributions | 30,988,314 | 21,137,926 |
| Capital grants received | 6,467,849 | 3,533,213 |
| Proceeds from sale of utility plant | 5,124 | 1,507,840 |
| (Increase) in other deferred assets and charges | (19,142,835) | (14,560,660) |
| Net cash used in capital and related financing activities | (260,522,371) | (260,860,190) |
| INVESTING ACTIVITIES: | | |
| Interest received on investments and on cash and equity in pooled investments | 10,251,091 | 9,837,914 |
| Net cash provided by investing activities | 10,251,091 | 9,837,914 |
| NET INCREASE/(DECREASE) IN CASH AND EQUITY IN POOLED INVESTMENTS | (39,817,750) | (19,061,571) |
| CASH AND EQUITY IN POOLED INVESTMENTS: | | |
| Beginning of year | 158,651,066 | 177,712,637 |
| End of year | $ 118,833,316 | $ 158,651,066 |

| | 2007 | 2006 |
|---|---|---|
| RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | |
| Net operating income | $ 130,348,674 | $ 189,768,330 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Non-cash items included in operating income: | | |
| Depreciation | 78,519,585 | 76,229,612 |
| Amortization of deferred credits | (5,687,800) | (5,277,747) |
| Amortization of other deferred charges | 12,288,798 | 11,850,756 |
| Bad debt expense | 4,061,778 | 11,436,243 |
| Power revenues | (106,476,981) | (61,154,891) |
| Power expenses | 106,364,389 | 61,236,376 |
| Other | 7,491,690 | 2,806,146 |
| Change in: | | |
| Accounts receivable | 5,077,326 | (17,852,150) |
| Unbilled revenues | 4,969,379 | (3,753,620) |
| Materials and supplies | (6,578,566) | (2,705,761) |
| Prepayments, interest receivable, and other | (656,769) | (1,552,705) |
| Other deferred assets and charges | (8,726,703) | (6,151,201) |
| Provision for injuries and damages and claims payable | 1,565,970 | (2,010,234) |
| Accounts payable, accrued payroll, and other | (4,460,430) | (9,134,772) |
| Total adjustments | 87,751,666 | 53,966,052 |
| Net cash provided by operating activities | $ 218,100,340 | $ 243,734,382 |
| SUPPLEMENTAL DISCLOSURES OF NONCASH ACTIVITIES: | | |
| In-kind capital contributions | $ 5,768,343 | $ 504,288 |
| Amortization of debt related costs—net | (2,176,157) | (2,336,219) |
| Change in valuation of derivative financial instruments | (6,298,016) | 5,930,269 |
| Change in valuation of deferred gain on power exchange | (22,692) | (1,003,353) |
| Allowance for funds used during construction | 2,690,637 | 2,575,745 |
| Power exchange revenues | 50,546,267 | 22,320,487 |
| Power exchange expenses | (50,401,511) | (20,879,703) |
| Change in capitalized purchased power commitment/obligation | (10,652,753) | (10,489,628) |
| Note assumed for software agreement | | 831,598 |
| Power revenue netting activity | 12,443,673 | 38,834,404 |
| Power expense netting activity | (43,171,799) | (40,356,674) |

See notes to financial statements.

### 1. OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City Light Department (the "Department") is the public electric utility of the City of Seattle (the "City"). The Department owns and operates certain generating, transmission, and distribution facilities and supplies electricity to approximately 385,000 customers. The Department supplies electrical energy to other City agencies at rates prescribed by City ordinances. The establishment of the Department's rates is within the exclusive jurisdiction of the Seattle City Council. A requirement of Washington State law provides that rates must be fair, nondiscriminatory, and fixed to produce revenue adequate to pay for operation and maintenance expenses and to meet all debt service requirements payable from such revenue. The Department pays occupation taxes to the City based on total revenues.

The Department's revenues were $16.9 million and $12.8 million for electrical energy and $2.3 million and $2.2 million for nonenergy services provided to other City departments in 2007 and 2006, respectively.

The Department receives certain services from other City departments and paid approximately $39.8 million and $32.9 million, respectively, in 2007 and 2006 for such services. Amounts paid include central cost allocations from the City for services received including treasury services, risk financing, purchasing, data processing systems, vehicle maintenance, personnel, payroll, legal, other administrative, and building rentals, including for the Department's administrative offices.

The Department's due from other City departments totaled $.7 million and $1.4 million at December 31, 2007 and 2006. The Department's due to other City departments totaled $11.5 million and $6.2 million at December 31, 2007 and 2006. The balances due from and to are the result of transactions incurred in the normal course of operations.

***Accounting Standards***—The accounting and reporting policies of the Department are regulated by the Washington State Auditor's Office, Division of Municipal Corporations, and are based on the Uniform System of Accounts prescribed for public utilities and licensees by the Federal Energy Regulatory Commission ("FERC"). The financial statements are also prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Department has applied and is current through 2007 with all applicable GASB pronouncements as well as Statements and Interpretations of the Financial Accounting Standards Board ("FASB"), Accounting Principles Board ("APB") Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures, except for those that conflict with or contradict GASB pronouncements.

Effective January 1, 2006, the Department adopted SFAS No. 153*, Exchanges of Nonmonetary Assets—an amendment of APB Opinion No. 29.* This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. These nonmonetary exchanges are to be measured at fair value. Accounting for power exchanges under short-term and long-term contracts is affected by this statement. Previously, these transactions were recognized by the Department at the blended weighted-average cost of power in accordance with APB Opinion No. 29. The effect of implementing SFAS No. 153 on January 1, 2006 is noted in Note 10.

***Equity***—The Department classifies its equity into three components as follows:

- *Invested in capital assets—net of related debt*—This component consists of capital assets, net of accumulated depreciation reduced by the net outstanding debt balances related to capital assets, net of unamortized debt expenses.

- *Restricted*—This component consists of equity with constraints placed on use. Constraints include those imposed by creditors (such as through debt covenants and excluding amounts considered in net capital, above), grants, or laws and regulations of other governments, or by enabling legislation, the City of Seattle Charter, or by ordinances legislated by the Seattle City Council.

- *Unrestricted*—This component consists of assets and liabilities that do not meet the definition of “invested in capital assets—net of related debt” or “restricted.”

***Restricted and Unrestricted Equity***—The Department’s policy is to use restricted equity for their intended purpose and to use unrestricted equity for operating expenses. The Department does not currently incur expenses for which both restricted and unrestricted equity is available.

In September 2005, the bond reserve account was liquidated and a portion of these funds was used to establish a Contingency Reserve Account in the amount of $25.0 million in accordance with City of Seattle Ordinance No. 121812. This account is restricted for extraordinary costs associated with the operation of the electrical system. There was no associated liability for the Contingency Reserve Account as of December 31, 2007.

***Assets Held for Future Use***—These assets include property acquired but never used by the Department in electrical service and therefore, held for future service under a definitive plan. Also included is property previously used in service but retired and held pending its reuse in the future under a definitive plan. As of December 31, 2007 and 2006, assets held for future use included the following electrical plan assets: substations, ducts and vaults, and transmission lines totaling $10.2 million and $10.6 million, respectively.

***Fair Value of Financial Instruments***—The Department’s financial instruments include cash and cash equivalents, short-term investments, receivables, payables, and long-term debt. The carrying value of these financial instruments other than long-term debt approximates fair value because of their short maturity or because they are based on year-end quoted market prices. Accordingly, the Department’s financial instruments other than long-term debt are reported at fair value on the accompanying balance sheets at December 31, 2007 and 2006. In addition, certain forward power contracts that are considered derivative instruments along with certain power exchange transactions are valued at fair value and related gains and losses resulting from fair valuation are deferred pursuant to SFAS No. 71.

***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.

***Revenue Recognition***—Service rates are authorized by City ordinances. Billings are made to customers on a monthly or bimonthly basis. Revenues for energy delivered to customers between the last billing date and the end of the year are estimated and reflected in the accompanying financial statements under the caption unbilled revenues.

The Department's customer base accounted for electric energy sales at December 31, 2007 and 2006, as follows:

| | 2007 | 2006 |
|---|---|---|
| Residential | 36.1 % | 34.3 % |
| Nonresidential | 63.9 | 65.7 |
| Total | 100.0 % | 100.0 % |

Revenues earned in the process of delivering energy to customers, wholesale energy transactions, and related activities are considered operating revenues in the determination of net income. Investment income, nonexchange transactions, and other revenues are considered nonoperating revenues.

***Expense Recognition***—Expenses incurred in the process of delivering energy to customers, wholesale energy transactions, and related activities are considered operating expenses in the determination of net income. Debt interest expense, debt related amortization, and certain other expenses are considered nonoperating expenses.

***Administrative and General Overhead Costs Applied***—Administrative and general costs are allocated to construction work-in-progress, major data processing systems development, programmatic conservation, relicensing mitigation projects, and billable operations and maintenance activities based on rates established by cost studies. Pension and benefit costs are fully allocated to capital and operations and maintenance activities based on a percentage of labor dollars. The administrative and general overhead costs applied totaled $23.7 million and $25.4 million in 2007 and 2006, respectively. Pension and benefit costs were $28.9 million and $26.1 million in 2007 and 2006, respectively. Administrative and general expenses, net of total applied overhead, were $66.6 million and $49.0 million in 2007 and 2006, respectively.

***Interest Charged to Construction***—Interest is charged for funds used during construction of plant assets and to nonbillable construction work-in-progress. Interest charged represents the estimated costs of financing construction projects and is computed using the Department's weighted-average interest rate for all bonds outstanding at the end of the year. Interest charged to construction totaled $2.7 million and $2.6 million in 2007 and 2006, respectively, and is reflected as a reduction of interest expense in the statements of revenues, expenses, and changes in equity.

***Nonexchange Transactions***—Capital contributions and grants in the amount of $46.1 million and $31.8 million are reported for 2007 and 2006, respectively, on the statements of revenues, expenses, and changes in equity as nonoperating revenues from nonexchange transactions. Capital contributions and grants revenues are recognized based on the accrual basis of accounting. In-kind capital contributions are recognized in the period when all eligibility requirements have been met as described in GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, and are recognized at fair market value. The determination of the fair market value is based on either the internal engineer's estimate of the current cost of comparable plant-in-service or the donor's actual cost. Federal and state grant revenues are recognized as earned and are subject to contract and other compliance audits.

***Compensated Absences***—Permanent employees of the Department earn vacation time in accordance with length of service. A maximum of 480 hours may be accumulated and, upon termination, employees are entitled to compensation for unused vacation. At retirement, employees receive compensation equivalent to 25% of their accumulated sick leave or effective 2006 may elect tax-free conversion of 35% of their sick leave balance to a health reimbursement account (HRA). The HRA program is administered by Rehn & Associates; HRA investments are managed by HRA VEBA Trust Operations. The Department accrues all costs associated with compensated absences, including payroll taxes.

***Use of Estimates*—**The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements. The Department used significant estimates in determining reported allowance for doubtful accounts, unbilled revenues, energy contract assets and liabilities, accumulated provision for injuries and damages, accrued sick leave, and other contingencies. Actual results may differ from those estimates.

***Significant Risk and Uncertainty***—The Department is subject to certain business risks that could have a material impact on future operations and financial performance. These risks include prices on the wholesale markets for short-term power transactions; interest rates; water conditions, weather, and natural disaster-related disruptions; terrorism; collective bargaining labor disputes; fish and other Endangered Species Act ("ESA") issues; Environmental Protection Agency ("EPA") regulations; federal government regulations or orders concerning the operations, maintenance, and/or licensing of hydroelectric facilities; other governmental regulations; restructuring of the electrical utility industry; and the costs of constructing transmission facilities that may be incurred as part of a northwest regional transmission system, and related effects of this system on transmission rights, transmission sales, the value of surplus energy, and governance.

***Reclassifications***—Certain 2006 account balances have been reclassified to conform to the 2007 presentation.

## 2. UTILITY PLANT

***Utility Plant*—**Utility plant is recorded at original cost, which includes both direct costs of construction or acquisition and indirect costs, including an allowance for funds used during construction. The capitalization threshold was $5,000 in 2007 and 2006. Property constructed with capital fees received from customers is included in utility plant. Capital fees totaled $37.7 million in 2007 and $21.4 million in 2006. Provision for depreciation is made using the straight-line method based upon estimated economic lives, which range from 3 to 50 years, of related operating assets. The Department uses a half-year convention method on the assumption that additions and replacements are placed in service at mid-year. The composite depreciation rate was approximately 3.0% in 2007 and 3.0 % in 2006. When operating plant assets are retired, their original cost together with removal costs, less salvage, is charged to accumulated depreciation. The cost of maintenance and repairs is charged to expense as incurred, while the cost of replacements and betterments is capitalized. The Department periodically reviews long-lived assets for impairment to determine whether any events or circumstances indicate the carrying value of the assets may not be recoverable. No impairment was identified in 2007 or 2006.

Utility plant-in-service at original cost, excluding land, at December 31, 2007 and 2006, was:

| 2007 | Hydraulic Production | Transmission | Distribution | General | Total |
|---|---|---|---|---|---|
| Original cost: | | | | | |
| Beginning balance | $624,274,271 | $158,732,010 | $1,346,854,631 | $355,628,069 | $2,485,488,981 |
| Capital acquisitions | 11,634,127 | 5,756,508 | 85,014,964 | 15,350,827 | 117,756,426 |
| Dispositions | (2,480,053) | (190,004) | (3,959,070) | (2,241,092) | (8,870,219) |
| Transfers and adjustments | 804,896 | | 10,626,761 | 55,160 | 11,486,817 |
| Total original cost | 634,233,241 | 164,298,514 | 1,438,537,286 | 368,792,964 | 2,605,862,005 |
| Accumulated depreciation: | | | | | |
| Beginning balance | 307,075,915 | 70,279,113 | 499,148,271 | 232,982,245 | 1,109,485,544 |
| Increase in accumulated depreciation | 12,537,792 | 3,535,103 | 41,857,793 | 21,480,028 | 79,410,716 |
| Retirements | (3,019,809) | (501,688) | (8,125,799) | (2,371,925) | (14,019,221) |
| Retirement work-in-process | (51,369) | (1,963) | (255,715) | 391 | (308,656) |
| Total accumulated depreciation | 316,542,529 | 73,310,565 | 532,624,550 | 252,090,739 | 1,174,568,383 |
| Ending balance | $317,690,712 | $ 90,987,949 | $ 905,912,736 | $116,702,225 | $1,431,293,622 |

| 2006 | Hydraulic Production | Transmission | Distribution | General | Total |
|---|---|---|---|---|---|
| Original cost: | | | | | |
| Beginning balance | $607,845,610 | $149,637,146 | $1,254,331,982 | $344,904,112 | $2,356,718,850 |
| Capital acquisitions | 18,179,093 | 9,292,426 | 77,534,616 | 11,888,491 | 116,894,626 |
| Dispositions | (1,750,432) | (491,993) | (3,915,545) | (1,105,515) | (7,263,485) |
| Transfers and adjustments | | 294,430 | 18,903,578 | (59,018) | 19,138,990 |
| Total original cost | 624,274,271 | 158,732,009 | 1,346,854,631 | 355,628,070 | 2,485,488,981 |
| Accumulated depreciation: | | | | | |
| Beginning balance | 297,675,624 | 67,645,115 | 469,069,141 | 212,665,550 | 1,047,055,430 |
| Increase in accumulated depreciation | 12,367,505 | 3,270,096 | 38,904,274 | 21,536,670 | 76,078,545 |
| Retirements | (2,918,189) | (645,383) | (8,272,612) | (1,226,397) | (13,062,581) |
| Retirement work-in-progress | (49,025) | 9,285 | (552,532) | 6,422 | (585,850) |
| Total accumulated depreciation | 307,075,915 | 70,279,113 | 499,148,271 | 232,982,245 | 1,109,485,544 |
| Ending balance | $317,198,356 | $ 88,452,896 | $ 847,706,360 | $122,645,825 | $1,376,003,437 |

## 3. CASH AND EQUITY IN POOLED INVESTMENTS

***Cash and Equity in Pooled Investments***—Cash resources of the Department are combined with cash resources of the City to form a pool of cash that is managed by the City's Department of Executive Administration ("DEA"). Under the City's investment policy, DEA invests and manages all temporary cash surpluses in the pool. The Department's share of the pool is included in the balance sheets under the caption "cash and equity in pooled investments" or accounts within restricted cash. The pool operates like a demand deposit account in that all agencies, including the Department, may deposit cash at any time and can also withdraw cash out of the pool without prior notice or penalty. Accordingly, the statements of cash flows reconcile to cash and equity in pooled investments. The city considers investments in financial instruments having a maturity of 90 days or less as a cash equivalent.

***Custodial Credit Risk—Deposits***—As of December 31, 2007 and 2006, the City's pool contained cash on deposit with the City's custodial banks in the amounts of $14,487,958 and $20,542,798 respectively. Custodial credit risk is the risk that the deposits may not be returned to the City in the event of a bank failure. The Federal Deposit Insurance Corporation ("FDIC") insures the City's deposits up to $100,000. All deposits not covered by FDIC insurance are covered by the Public Deposit Protection Commission ("PDPC") of the State of Washington. The PDPC is a statutory authority established under the Revised

Code of Washington (RCW) 39.58. It constitutes a multiple financial institution collateral pool. In the case of a loss by any public depository in the state, each public depository is liable for an amount up to 11% of its public deposits. Provisions of RCW 39.58.060 authorize the PDPC to make pro-rata assessments in proportion to the maximum liability of each such depository as it existed on the date of loss. Therefore, PDPC protection is that of collateral, not of insurance.

***Investments***—The Department's cash resources may be invested by DEA separate from the cash and investments pool. Investments are managed in accordance with the City's investment policy, with limits and restrictions applied at the City-wide level rather than to specific investments of the Department. The city considers an investment held for more than one year as a long-term investment.

As of December 31, 2007 and 2006, the Department's dedicated investments and the City's pool and other investments were as follows:

| **2007** | **Fair Value** | | | | **Weighted-Average Maturity (Days)** |
|---|---|---|---|---|---|
| | **Dedicated Investments of the Department** | **City Pool** | **Other City Dedicated Investments** | **Total** | |
| U.S. government agencies | $ - | $ 563,723,234 | $ 5,554,398 | $ 569,277,632 | 804 |
| Municipal bonds taxable | | 34,927,394 | 13,578,497 | 48,505,891 | 288 |
| Commercial paper | | 219,776,326 | | 219,776,326 | 12 |
| U.S. government obligations | | 15,370,313 | | 15,370,313 | 517 |
| Repurchase agreements | | 92,283,483 | | 92,283,483 | 2 |
| Total | $ - | $ 926,080,750 | $ 19,132,895 | $ 945,213,645 | |
| Portfolio weighted-average maturity | | | | | 507 |

| **2006** | **Fair Value** | | | | **Weighted-Average Maturity (Days)** |
|---|---|---|---|---|---|
| | **Dedicated Investments of the Department** | **City Pool** | **Other City Dedicated Investments** | **Total** | |
| U.S. government agencies | $ - | $ 487,816,597 | $ 61,903,104 | $ 549,719,701 | 325 |
| Municipal bonds taxable | | 7,928,395 | | 7,928,395 | 182 |
| Commercial paper | | 200,814,310 | 28,656,174 | 229,470,484 | 18 |
| U.S. government obligations | | 24,914,063 | | 24,914,063 | 46 |
| Repurchase agreements | | 112,044,546 | | 112,044,546 | 2 |
| Total | $ - | $ 833,517,911 | $ 90,559,278 | $ 924,077,189 | |
| Portfolio weighted-average maturity | | | | | 201 |

As of December 31, 2007 and 2006, the Department's share of the City pool was as follows:

| | 2007 | 2006 |
|---|---|---|
| Cash and equity in pooled investments: | | |
| Restricted assets | $ 31,109,383 | $ 31,502,946 |
| Current assets | 87,723,934 | 127,148,120 |
| Total | $ 118,833,317 | $ 158,651,066 |
| Balance as a percentage of City pool | 12.8 % | 19.0 % |

***Interest Rate Risk***—Interest rate risk is the risk that changes in interest rates over time will adversely affect the fair value of an investment. In accordance with its investment policy, the City manages its exposure to declines in fair values by limiting the weighted-average maturity of its investment portfolio to no longer than five years. Furthermore, to achieve its financial objective of maintaining liquidity to meet its operating cash flow needs, the City typically selects investments that have much shorter average maturities.

***Credit Risk***—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In accordance with its investment policy, the City manages its exposure to credit risk by limiting its investments in commercial paper purchased on the secondary market to those with maturities not longer than 180 days from purchase and with the highest rating by at least two nationally recognized statistical rating organizations ("NRSRO"). As of December 31, 2007 and 2006, the City's investments in commercial paper were rated P-1 by Moody's Investors Service, A-1 or A-1+ by Standard & Poor's, or F-1 by Fitch Ratings.

The City also purchases obligations of government-sponsored enterprises, which are eligible as collateral for advances to member banks as determined by the Board of Governors of the Federal Reserve System. These include, but are not limited to, debt securities of Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Federal Farm Credit Bank, and Federal National Mortgage Association. As of December 31, 2007 and 2006, these investments were rated Aaa by Moody's Investors Service and AAA by Standard & Poor's.

The City's investments in repurchase agreements require a master repurchase agreement executed with the counterparty and may only be conducted with primary dealers, the City's bank of record, or master custodial bank. Securities delivered as collateral must be priced at a minimum of 102% of their market value for U.S. Treasuries and at higher margins of 103% to 105% for debentures of U.S. federal government-sponsored enterprises, mortgage-backed pass-throughs, banker's acceptances, and commercial paper. In addition, collateral securities must have the highest credit ratings of at least two NRSROs. Repurchase agreements themselves do not carry a credit rating as of December 31, 2007 and 2006, the securities underlying the City's investment in repurchase agreements included collateral other than U.S. Treasuries.

***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. In accordance with its investment policy, the City manages its exposure to concentration of credit risk for the City's investments portfolio as a whole. The City limits its investments in any one issuer to no more than 20% of its portfolio, except for investments in U.S. government obligations or U.S. government agency securities, which may comprise up to 100% of the portfolio. The City's investments in which 5% or more is invested in any single issuer as of December 31, 2007 and 2006, were as follows:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| **Issuer** | **Fair Value** | **Percent of Total Investments** | **Fair Value** | **Percent of Total Investments** |
| Bank of America | $ 91,600,000 | 10 % | $ 111,000,000 | 12 % |
| Federal Home Loan Mortgage Corporation | 168,023,684 | 18 | 177,957,324 | 19 |
| Federal National Mortgage Corporation | 198,573,365 | 21 | 166,586,419 | 18 |
| Federal Home Loan Bank | 182,696,219 | 19 | 185,438,458 | 20 |
| Total | $ 640,893,268 | 68 % | $ 640,982,201 | 69 % |

The Department did not have any dedicated investments and therefore, did not have investments in which 5% or more is invested in any single issuer as of December 31, 2007 and 2006.

***Custodial Credit Risk***—Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. In accordance with its investment policy, the City maintains a list of security dealers and financial institutions authorized to provide investment services to the City. The security dealers and financial institutions may include primary dealers or regional dealers that qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule) and investment departments of local banks which passed evaluation of their financial condition, strength, and capability to fulfill commitments; overall reputation with other dealers and investors; regulatory status; and background and expertise on their individual representative.

***Foreign Currency Risk***—The City treasury investments pool and securities held for dedicated funds do not have any exposure to foreign currency risk.

***Securities Lending Transactions***—The City is authorized to engage in securities lending transactions similar to that instituted by the Washington State Treasurer's Office and other municipal corporations in the State of Washington. There were no securities lending transactions outstanding as of December 31, 2007 and 2006.

***Reverse Repurchase Agreements***—The City may enter into reverse repurchase agreements as part of its investment policies. These agreements are sales of securities with a simultaneous agreement to repurchase the securities at a future date at the same prices plus contracted rates of interest. The fair value of the securities underlying the agreements normally exceeds the cash received, providing the dealers a margin against a decline in the fair value of the securities. If the dealers default on their obligations to resell these securities to the City, or provide securities or cash of equal value, the City would suffer an economic loss equal to the difference between the fair value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. There were no outstanding reverse repurchase agreements as of December 31, 2007 and 2006.

## 4. ACCOUNTS RECEIVABLE

Accounts receivable at December 31, 2007 and 2006, consist of:

| | Retail Electric | Wholesale Power | Other Operating | Operating Subtotal | Nonoperating Subtotal | Total |
|---|---|---|---|---|---|---|
| **2007** | | | | | | |
| Accounts receivable | $ 44,802,691 | $ 17,764,875 | $ 3,216,278 | $ 65,783,844 | $ 11,920,617 | $ 77,704,461 |
| Less allowance for doubtful accounts | (3,650,000) | (885,068) | (1,489,000) | (6,024,068) | | (6,024,068) |
| | $ 41,152,691 | $ 16,879,807 | $ 1,727,278 | $ 59,759,776 | $ 11,920,617 | $ 71,680,393 |
| **2006** | | | | | | |
| Accounts receivable | $ 62,334,650 | $ 20,400,149 | $ 8,981,303 | $ 91,716,102 | $ 12,278,048 | $103,994,150 |
| Less allowance for doubtful accounts | (20,971,000) | (885,762) | (1,465,000) | (23,321,762) | | (23,321,762) |
| | $ 41,363,650 | $ 19,514,387 | $ 7,516,303 | $ 68,394,340 | $ 12,278,048 | $ 80,672,388 |

## 5. SHORT-TERM POWER CONTRACTS AND DERIVATIVE INSTRUMENTS

The Department enters into short-term forward contracts to purchase or sell energy. Under these forward contracts, the Department commits to purchase or sell a specified amount of energy at a specified time, or during a specified time in the future. Certain of the forward contracts are considered derivative instruments as they may be net-settled without physical delivery. These derivative instruments, along with other short-term power transactions, are entered into for the purpose of managing the Department's resources to meet load requirements and to realize earnings from surplus energy resources. Except for limited intraday and interday trading to take advantage of owned hydro storage, the Department does not take market positions in anticipation of generating revenue. Power transactions in response to forecasted seasonal resource and demand variations require approval by the Department's Risk Oversight Council. Fluctuations in annual precipitation levels and other weather conditions materially affect the energy output from the Department's hydroelectric facilities and some of its long-term purchased hydroelectric power agreements. Demand fluctuates with weather and local economic conditions. Accordingly, short-term power transactions required to manage resources to meet the Department's load and dispose of surplus energy may vary from year to year.

The fair value of the Department's derivative financial instruments at December 31 as follows:

| | 2007 | 2006 |
|---|---|---|
| Derivative financial instrument - current assets: | | |
| Forward electric energy sales | $ 854,726 | $ 6,680,264 |
| Derivative financial instrument - current liabilities: | | |
| Forward electric energy sales | $ 663,534 | $ 191,056 |
| Regulatory deferred gain - deferred credits: | 191,192 | 6,489,208 |
| | $ 854,726 | $ 6,680,264 |

The Seattle City Council has deferred recognition of the effects of reporting the fair value of derivative financial instruments for rate-making purposes, and maintains regulatory accounts to defer the accounting impact of these accounting adjustments in accordance with SFAS No. 71 (see also Notes 11 and 12).

## 6. LONG-TERM DEBT

At December 31, 2007 and 2006, the Department's long-term debt consisted of the following:

| LONG-TERM | | Fixed Rate | Year Due | 2007 | 2006 |
|---|---|---|---|---|---|
| Prior Lien Bonds: | | | | | |
| 2004 | ML&P Improvement and Refunding Revenue Bonds | 3.000%–5.250% | 2029 | $ 266,785,000 | $ 272,785,000 |
| 2003 | ML&P Improvement and Refunding Revenue Bonds | 4.000%–6.000% | 2028 | 170,845,000 | 194,665,000 |
| 2002 | ML&P Refunding Revenue Bonds | 3.000%–4.500% | 2014 | 49,220,000 | 58,475,000 |
| 2001 | ML&P Improvements and Refunding Revenue Bonds | 5.000%–5.500% | 2026 | 480,560,000 | 487,550,000 |
| 2000 | ML&P Revenue Bonds | 4.500%–5.625% | 2025 | 92,940,000 | 95,955,000 |
| 1999 | ML&P Revenue Bonds | 5.000%–6.000% | 2024 | 13,500,000 | 16,750,000 |
| 1998B | ML&P Revenue Bonds | 4.750%–5.000% | 2024 | 78,885,000 | 81,835,000 |
| 1998A | ML&P Refunding Revenue Bonds | 4.500%–5.000% | 2020 | 86,980,000 | 92,045,000 |
| 1997 | ML&P Revenue Bonds | 5.000%–5.125% | 2022 | 24,930,000 | 26,035,000 |
| Total prior lien bonds | | | | 1,264,645,000 | 1,326,095,000 |
| Subordinate Lien Bonds: | | | | | |
| 1996 | ML&P Adjustable Rate Revenue Bonds | variable rates | 2021 | 15,415,000 | 16,220,000 |
| 1993 | ML&P Adjustable Rate Revenue Bonds | variable rates | 2018 | 13,900,000 | 14,900,000 |
| 1991B | ML&P Adjustable Rate Revenue Bonds | variable rates | 2016 | 9,500,000 | 11,700,000 |
| 1991A | ML&P Adjustable Rate Revenue Bonds | variable rates | 2016 | 25,000,000 | 25,000,000 |
| 1990 | ML&P Adjustable Rate Revenue Bonds | variable rates | 2015 | 14,000,000 | 15,300,000 |
| Total subordinate lien bonds | | | | 77,815,000 | 83,120,000 |
| Notes Payable— | | | | | |
| 2006 | Note Payable—State of Washington | 5.000% | 2008 | 284,853 | 3,956,493 |
| 2005 | Note Payable—Sound Transit | variable rates | 2007 | - | 555,104 |
| | | | | 284,853 | 4,511,597 |
| Total long-term debt | | | | $1,342,744,853 | $1,413,726,597 |

The Department had the following activity in long-term debt during 2007 and 2006:

| 2007 | Balance at December 31, 2006 | Additions | Reductions | Balance at December 31, 2007 | Current Portion |
|---|---|---|---|---|---|
| Prior Lien Bonds | $ 1,326,095,000 | $ - | $(61,450,000) | $1,264,645,000 | $64,620,000 |
| Subordinate Lien Bonds | 83,120,000 | | (5,305,000) | 77,815,000 | 5,840,000 |
| Note payable—Sound Transit | 3,956,493 | | (3,956,493) | | |
| Note payable—State of Washington | 555,104 | | (270,251) | 284,853 | 284,853 |
| Total | $ 1,413,726,597 | $ - | $(70,981,744) | $1,342,744,853 | $70,744,853 |

| 2006 | Balance at December 31, 2005 | Additions | Reductions | Balance at December 31, 2006 | Current Portion |
|---|---|---|---|---|---|
| Prior Lien Bonds | $ 1,384,755,000 | $ - | $(58,660,000) | $1,326,095,000 | $61,450,000 |
| Subordinate Lien Bonds | 87,895,000 | | (4,775,000) | 83,120,000 | 5,305,000 |
| Note payable—Sound Transit | 9,593,840 | 956,793 | (6,594,140) | 3,956,493 | 3,956,493 |
| Note payable—State of Washington | | 831,598 | (276,494) | 555,104 | 270,251 |
| Total | $ 1,482,243,840 | $ 1,788,391 | $(70,305,634) | $1,413,726,597 | $70,981,744 |

***Prior Lien Bonds***—In December 2004, the Department issued $284.9 million in ML&P Improvement and Refunding Revenue Bonds that bear interest at rates ranging from 3.00% to 5.25% and mature serially from August 1, 2005 through 2025. Proceeds were used to finance certain capital improvements and conservation programs and to defease certain outstanding 1995A, 1996, and 1999 series prior lien bonds. There were no additional bonds issued during 2007 and 2006.

Debt service requirements for prior lien bonds are as follows:

| Years Ending December 31 | Principal Redemptions | Interest Requirements | Total |
|---|---|---|---|
| 2008 | $ 64,620,000 | $ 63,596,351 | $ 128,216,351 |
| 2009 | 67,990,000 | 60,235,645 | 128,225,645 |
| 2010 | 71,525,000 | 56,698,740 | 128,223,740 |
| 2011 | 66,995,000 | 53,286,445 | 120,281,445 |
| 2012 | 66,850,000 | 50,253,820 | 117,103,820 |
| 2013–2017 | 352,820,000 | 196,663,556 | 549,483,556 |
| 2018–2022 | 329,845,000 | 107,080,694 | 436,925,694 |
| 2023–2027 | 227,265,000 | 29,407,572 | 256,672,572 |
| 2028–2029 | 16,735,000 | 984,231 | 17,719,231 |
| Total | $1,264,645,000 | $618,207,054 | $1,882,852,054 |

The Department was required by ordinance to fund reserves for prior lien bond issues in an amount equal to the lesser of (a) the maximum annual debt service on all bonds secured by the reserve account or (b) the maximum amount permitted by the Internal Revenue Code ("IRC") of 1986 as a reasonably required reserve or replacement fund. Upon issuance of the 2004 bonds, the maximum annual debt service on prior lien bonds was $128.2 million due and paid in 2006. The maximum amount of the reserve permitted by the IRC was $113.3 million. At December 31, 2004, the balance in the reserve account was $87.0 million at fair value. In September 2005, the Department purchased a Municipal Bond (Surety Bond) to replace the reserve account authorized by Ordinance No. 121812. Accordingly, the funds in the reserve account of $87.4 million, were used to fund a new $25.0 million Contingency Reserve Account, also authorized by Ordinance No. 121812. The balance of $62.4 million was used for additional long-term debt reduction by transferring these funds to the Construction Account for authorized capital expenditures.

A portion of the proceeds from the 2004 refunding bonds were placed in a separate irrevocable trust to provide for all future debt service payments on the bonds defeased. The balance outstanding in the irrevocable trust during 2007 and 2006 was for the 2004 series. Neither the assets of the trust account nor the liabilities for the defeased bonds are reflected in the Department's financial statements. The bonds defeased in 2004 had an outstanding principal balance of $138.3 million as of December 31, 2007 and 2006, respectively. Funds held in the 2004 trust account on December 31, 2007, are sufficient to service and redeem the defeased bonds.

***Subordinate Lien Bonds***—The Department is authorized to issue a limited amount of adjustable rate revenue bonds, which are subordinate to prior lien bonds with respect to claims on revenues. Subordinate lien bonds may be issued to the extent that the new bonds will not cause the aggregate principal amount of such bonds then outstanding to exceed the greater of $70.0 million or 15% of the aggregate principal amount of prior lien bonds then outstanding. Subordinate bonds may be remarketed daily, weekly, short term, or long term and may be converted to prior lien bonds when certain conditions are met. The subordinate lien bonds are supported by a letter of credit issued by JP Morgan Chase Bank that provides credit and liquidity support for the principal amounts and accrued interest then outstanding in the event that the subordinate lien bonds are not able to be remarketed. The letter of credit expires on January 31, 2010.

Future debt service requirements on the subordinate lien bonds, based on 2007 end of year actual interest rates ranging from 3.27% to 3.42% through year 2021, are as follows:

| Years Ending December 31 | Principal Redemptions | Interest Requirements | Total |
|---|---|---|---|
| 2008 | $ 5,840,000 | $ 2,510,779 | $ 8,350,779 |
| 2009 | 6,270,000 | 2,312,471 | 8,582,471 |
| 2010 | 6,705,000 | 2,100,042 | 8,805,042 |
| 2011 | 7,345,000 | 1,871,142 | 9,216,142 |
| 2012 | 7,785,000 | 1,623,434 | 9,408,434 |
| 2013–2017 | 37,055,000 | 3,988,567 | 41,043,567 |
| 2018–2022 | 6,815,000 | 493,396 | 7,308,396 |
| Total | $ 77,815,000 | $ 14,899,831 | $ 92,714,831 |

***Fair Value***—The fair value of the Department's bonds is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the Department for debt of the same remaining maturities. Carrying amounts (net of premiums and discounts) and fair values at December 31, 2007 and 2006, are as follows:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Long-term debt: | | | | |
| Prior lien bonds | $ 1,293,365,796 | $ 1,310,243,325 | $ 1,358,529,557 | $ 1,397,098,567 |
| Subordinate lien bonds | 77,645,231 | 77,815,000 | 82,932,366 | 83,120,000 |
| Total | $ 1,371,011,027 | $ 1,388,058,325 | $ 1,441,461,923 | $ 1,480,218,567 |

***Amortization***—Bond issue costs, including the surety bond, discounts, and premiums are amortized using the effective interest method over the term of the bonds.

The excess of costs incurred over the carrying value of bonds refunded on early extinguishment of debt is amortized as a component of interest expense using both the straight-line and effective interest methods over the terms of the issues to which they pertain. Deferred refunding costs amortized to interest expense totaled $5.1 million in 2007 and $5.4 million in 2006. Deferred refunding costs in the amount of $37.3 million and $42.4 million are reported as a component of long-term debt in the 2007 and 2006 balance sheets, respectively.

***Note Payable—Sound Transit***—In 2003, the Department negotiated an agreement with Sound Transit, the regional transit authority, to perform electrical work pertaining to the undergrounding of utilities along Martin Luther King Way for the new light rail line under construction. There were two major components of this work. The first component consisted of installing an underground ductbank along Martin Luther King Way in South Seattle. The second element was to perform the necessary underground electrical work within the ductbank. Financial terms of this agreement were finalized during 2005 that resulted in a note payable to Sound Transit. Sound Transit completed the underground ductbank at a cost of $18.7 million, of which the Department was responsible for $11.8 million, payable to Sound Transit. The completed underground electrical work was financed in part by Sound Transit and the total amount due Sound Transit was $3.1 million. In 2006, the note payable was increased by nearly

$1.0 million for additional electrical work performed. The entire note payable was repaid in full by the end of 2007. The note payable had an interest rate of 3.9%, plus an inflation component.

***Note Payable—State of Washington***—In 2007, the Department negotiated a note payable with the State of Washington for the purchase of software installed in 2006 department-wide. The total amount of the note payable was $.8 million, maturing in 2008 at an imputed interest rate of 5%. During 2007, $.3 million was repaid leaving a balance of $.3 million at the end of the year. Debt service requirements are:

| Years Ending December 31 | Principal Redemptions | Interest Requirements | Total |
|---|---|---|---|
| 2008 | $ 284,853 | $ 7,196 | $ 292,049 |
| Total | $ 284,853 | $ 7,196 | $ 292,049 |

***Noncurrent Liabilities***—The Department had the following activities during 2007 and 2006:

| 2007 | Balance at 12/31/06 | Additions | Reductions | Balance at 12/31/07 | Current Portion |
|---|---|---|---|---|---|
| Compensated absences | $ 11,393,239 | $ 16,247,317 | $ (15,074,557) | $ 12,565,999 | $ 1,222,813 |
| Long-term purchased power obligation | 15,401,778 | - | (10,652,753) | 4,749,025 | 11,970,000 |
| Other | 185,864 | 1,273,023 | (7,163) | 1,451,724 | - |
| Total | $ 26,980,881 | $ 17,520,340 | $ (25,734,473) | $ 18,766,748 | $ 13,192,813 |

| 2006 | Balance at 12/31/05 | Additions | Reductions | Balance at 12/31/06 | Current Portion |
|---|---|---|---|---|---|
| Compensated absences | $ 10,990,644 | $ 13,798,752 | $ (13,396,157) | $ 11,393,239 | $ 1,005,628 |
| Long-term purchased power obligation | 25,891,406 | - | (10,489,628) | 15,401,778 | 11,770,000 |
| Other | 192,473 | 4,702 | (11,311) | 185,864 | - |
| Total | $ 37,074,523 | $ 13,803,454 | $ (23,897,096) | $ 26,980,881 | $ 12,775,628 |

## 7. ACCOUNTS PAYABLE

***Accounts Payable and Other***—The composition of accounts payable and other at December 31, 2007 and 2006, is as follows:

| | 2007 | 2006 |
|---|---|---|
| Vouchers payable | $ 19,285,347 | $ 13,355,570 |
| Power accounts payable | 23,838,333 | 30,788,258 |
| Interfund payable | 11,451,789 | 6,159,676 |
| Taxes payable | 8,987,501 | 9,511,145 |
| Claims payable—current | 8,096,900 | 9,936,774 |
| Guarantee deposit and contract retainer | 957,659 | 2,246,526 |
| Other accounts payable | 270,380 | 465,565 |
| Total | $ 72,887,909 | $ 72,463,514 |

## 8. SEATTLE CITY EMPLOYEES' RETIREMENT SYSTEM

The Seattle City Employees' Retirement System ("SCERS") is a single-employer defined benefit public employee retirement system, covering employees of the City and administered in accordance with Chapter 41.28 of the Revised Code of Washington and Chapter 4.36 of the Seattle Municipal Code. SCERS is a pension trust fund of the City.

All employees of the City are eligible for membership in SCERS with the exception of uniformed police and fire personnel who are covered under a retirement system administered by the State of Washington. Employees of Metro and the King County Health Department who established membership in SCERS when these organizations were City departments were allowed to continue their SCERS membership. As of December 31, 2007, there were 5,201 retirees and beneficiaries receiving benefits and 8,842 active members of SCERS. In addition, 2,050 vested terminated employees were entitled to future benefits.

SCERS provides retirement, death, and disability benefits. Retirement benefits vest after five years of credited service, while death and disability benefits vest after 10 years of service. Retirement benefits are calculated as 2% multiplied by years of creditable service, multiplied by average salary, based on the highest 24 consecutive months, excluding overtime. The benefit is actuarially reduced for early retirement. Future increases in the cost-of-living adjustments are available to current and future retired members only if SCERS attains at least a 95% funding level. SCERS does not provide termination benefits.

Actuarially recommended contribution rates both for members and for the employer were 8.03% of covered payroll during 2007 and 2006.

Under the authority of the state and City, SCERS operates a securities lending program, and there were transactions during 2007 and 2006. SCERS has had no losses resulting from a default, and SCERS did not have negative credit exposure at December 31, 2007 or 2006.

SCERS issues stand-alone financial statements that may be obtained by writing to the Seattle City Employees' Retirement System, 720 Third Avenue, Suite 1000, Seattle, WA 98104;
telephone: (206) 386-1293.

Employer contributions for the City were $40.2 million and $38.1 million in 2007 and 2006. Department contributions were $8.4 million and $8.0 million in 2007 and 2006. The annual required contributions were made in full.

**Actuarial Data**

| | |
|---|---|
| Valuation date | January 1, 2006 |
| Actuarial cost method | Entry age |
| Amortization method | Level percent |
| Remaining amortization period | 18.0 years, open |
| Amortization period | Maximum of 40 years |
| Asset valuation method | Market |

| **Actuarial Assumptions*** | **Percentage** |
|---|---|
| Investment rate of return | 7.75% |
| Projected general wage increases | 4.00 |
| Cost-of-living year-end bonus dividend | 0.67 |

* Includes price inflation at 3.5% and 0.5% of payroll growth.
Note: There are no post-retirement benefit increases assumed.

**Annual Pension Cost and Net Pension Obligation**
for Fiscal Year Ending December 31, 2005
Based on January 1, 2004 Valuation
(latest information available)

| | Years Ending December 31 | 2004 | 2005 |
|---|---|---|---|
| 1a | Total normal cost rate | 13.05 % | 13.05 % |
| 1b | Employee contribution rate | 8.03 % | 8.03 % |
| 1c | Employer normal cost rate (1a-1b) | 5.02 % | 5.02 % |
| 2a | Total employer contribution rate | 8.03 % | 8.03 % |
| 2b | Amortization payment rate (2a-1c) | 3.01 % | 3.01 % |
| 2c | Amortization period * | 30.20 % | 30.20 % |
| 2d | GASB 27 amortization rate | 3.01 % | 3.01 % |
| 3 | Total annual required contribution (ARC) rate (1c+2d) | 8.03 % | 8.03 % |
| 4 | Covered employee payroll ** | $ 456,808,182 | $ 447,040,411 |
| 5a | ARC (3x4) | $ 36,681,697 | $ 35,897,345 |
| 5b | Interest on net pension obligation (NPO) | (5,773,805) | (5,910,271) |
| 5c | ARC adjustment | 4,012,944 | 4,107,791 |
| 5d | Annual pension cost (APC) (5a+5b+5c) | $ 34,920,836 | $ 34,094,865 |
| 6 | Employer contribution | $ 36,681,697 | $ 35,897,345 |
| 7a | Change in NPO (5d-6) | (1,760,861) | (1,802,480) |
| 7b | NPO at beginning of year | (74,500,706) | (76,261,567) |
| 7c | NPO at end of year (7a+7b) | $ 76,261,567 | $ 78,064,047 |

* If the amortization period determined by the actual contribution rate exceeds the maximum amortization period required by GASB Statement No. 27, the ARC is determined using an amortization of the Funding Excess over 30 years.

** Covered payroll includes compensation paid to all active employees on which contributions were made in the year preceding the valuation period.

Schedule of funding progress for SCERS (dollar amounts in millions):

| Actuarial Valuation Date January 1, | Actuarial Value of Assets (a) | Actuarial Accrued Liabilities (“AAL”)(1) (b) | Unfunded AAL (“UAAL”)(2) (b-a) | Funding Ratio (a/b) | Covered Payroll(3) (c) | UAAL or (Excess) as a Percentage of Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| 2002 | $ 1,383.7 | $ 1,581.4 | $ 197.7 | 87.5 % | $ 405.1 | 48.8 % |
| 2004 | 1,527.5 | 1,778.9 | 251.4 | 85.9 | 424.7 | 59.2 |
| 2006 | 1,791.8 | 2,017.5 | 225.8 | 88.8 | 447.0 | 50.5 |

(1) Actuarial present value of benefits less actuarial present value of future normal costs based on entry age actuarial cost method.

(2) Actuarial accrued liabilities less actuarial value of assets; funding excess if negative.
(3) Covered payroll includes compensation paid to all active employees on which contributions are calculated.

***Other Postemployment Benefits***—Health care plans for active and retired employees are administered by the City of Seattle as single-employer defined benefit public employee health care plans.

Eligible retirees may contribute to the medical and any additional health care programs contemplated or amended by ordinance of the Seattle City Council and as provided in Seattle Municipal Code 4.50.020.

The Seattle City Council authorizes the obligations of the plan members and the City as employer by passing ordinances and amendments regarding contributions to the plans. Eligible retirees up to age 65 self-pay 100% of the premium based on blended rates which were established by including the experience of retirees with the experience of active employees for underwriting purposes. The plan is financed on a pay-as-you-go basis, and the City was required to contribute $1.4 million in 2007.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future. Actuarial calculations reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Significant methods and assumptions are as follows:

**Actuarial data and assumptions**

| | |
|---|---|
| Valuation date | January 1, 2006 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level dollar |
| Remaining amortization period | 30 years, closed |
| Discount rate | 5.125% |
| Health care cost trend rates—medical: | 12%, decreasing by 0.5% for each year for 12 years to an ultimate rate of 6%. |
| Participation | 45% of Active Employees who retire participate |
| Mortality | General Service Actives and Retirees based on the Group Annuity Mortality (GAM) 1994 Static Table (Final) with ages set forward one year. |
| Marital status | 60% of members electing coverage: married or have a registered domestic partner. Male spouses two years older than their female spouses. |
| Morbidity factors | Morbidity rate ranges for ages 50 through 64: 94.6% to 166.5% for male retirees, 106.9% to 134.3% for female retirees, 104.5% to 183.9% for male spouses, and 118.1% to 148.4% for female spouses. Retirees' spouses pay a lower premium than retirees. |
| Other considerations | Active employees with current spouse and/or dependent coverage elect same plan and coverage. |

Based on the actuarial valuation date of January 1, 2006, the City's annual cost for fiscal year ended December 31, 2007, the amount of expected contribution to the plan, and changes in net obligation are as follows:

| | 2007 |
|---|---|
| Annual required contribution | $ 9,328,990 |
| Interest on net OPEB obligation | - |
| Adjustment to annual required contribution | - |
| Annual OPEB cost (expense) | 9,328,990 |
| Expected contribution (employer-paid benefits) | (1,354,268) |
| Increase in net OPEB obligation | 7,974,722 |
| Net OPEB Obligation - beginning of the year | - |
| Net OPEB obligation - end of year | $ 7,974,722 |

Schedules of funding progress are as follows (dollars in millions):

| Actuarial Valuation Date January 1, | Actuarial Value of Assets (a) | Actuarial Accrued Liabilities ("AAL") Entry Age (b) | Unfunded AAL ("UAAL") (b-a) | Funding Ratio (a/b) | Covered Payroll (c) | UAAL as a Percentage of Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| 2006 | $ 0.0 | $ 84.3 | $ 84.3 | 0.0 % | N/A | N/A |

The Health Care Subfund of the General Fund is reported in the City's Comprehensive Annual Financial Report that can be obtained by writing the Department of Finance, City of Seattle, PO Box 94747, Seattle, WA 98124-4747.

## 9. DEFERRED COMPENSATION

The Department's employees may contribute to the City's Voluntary Deferred Compensation Plan (the "Plan"). The Plan, available to City employees and officers, permits participants to defer a portion of their salary until future years. The Plan administrator is Prudential Retirement. The deferred compensation is paid to participants and their beneficiaries upon termination, retirement, death, or unforeseeable emergency.

Effective January 1, 1999, the Plan became an eligible deferred compensation plan under Section 457 of the IRC of 1986, as amended, and a trust exempt from tax under IRC Sections 457(g) and 501(a). The Plan is operated for the exclusive benefit of participants and their beneficiaries. No part of the corpus or income of the Plan shall revert to the City or be used for, or diverted to, purposes other than the exclusive benefit of participants and their beneficiaries.

The Plan is not reported in the financial statements of the City or the Department.

It is the opinion of the City's legal counsel that the City has a low risk of liability for investment losses under the Plan. Participants direct the investment of their money into one or more options provided by the Plan and may change their selection from time to time. By enrolling in the Plan, participants accept and assume all risks inherent in the Plan and its administration.

## 10. LONG-TERM PURCHASED POWER, EXCHANGES, AND TRANSMISSION

***Bonneville Power Administration***—The Department purchases electric energy from the U.S. Department of Energy, Bonneville Power Administration ("Bonneville") under the Block and Slice Power Sales Agreement, a 10-year contract that expires September 30, 2011. The agreement provides power equal to the Department's annual net requirement, defined as the difference between projected load and firm resources declared to serve that load. The Block product provides fixed amounts of power per month.

In 2006, the Department and BPA amended the Block agreement to enable the Department to participate in the BPA Flexible Priority Firm (PF) Program. Under the provisions of this program, the Block product is subject to a Flexible PF Charge on a power bill increasing the amount payable by the Department for power service in a given month followed by reductions in the amount payable for power service in subsequent months until the charge is recovered. Participation in the program provides the Department with a monthly discount on its Block bill whether or not the Flexible PF Charge is applied. In order to participate, the Department was required to enter into an irrevocable standby letter of credit for $16.5 million issued by the Bank of America with a term from October 1, 2006 through September 30, 2009. The Flexible PF Charge was not applied in 2007 or 2006.

The terms of the Slice product specify that the Department will receive a fixed percentage (4.6676%) of the actual output of the Federal Columbia River Power System. The cost of Slice power is based on the Department's same percentage (4.6676%) of the expected costs of the system and is subject to true-up adjustments based on actual costs with specified exceptions. Subsequent amendments to the contract provide that Bonneville will pay the Department for qualified energy savings realized through specified programs and decrement Block purchases accordingly.

***Lucky Peak***—In 1984, the Department entered into a purchase power agreement with four irrigation districts to acquire 100% of the net output of a hydroelectric facility that began commercial operation in 1988 at the existing Army Corps of Engineers Lucky Peak Dam on the Boise River near Boise, Idaho. The irrigation districts are owners and license holders of the project, and the FERC license expires in 2030. The agreement, which expires in 2038, obligates the Department to pay all ownership and operating costs, including debt service, over the term of the contract, whether or not the plant is operating or operable. To properly reflect its rights and obligations under this agreement, the Department includes as an asset and liability the outstanding principal of the project's debt, net of the balance in the project's reserve account. The project's debt matures in July 2008.

***British Columbia—High Ross Agreement***—In 1984, an agreement was reached between the Province of British Columbia and the City under which British Columbia will provide the Department with power equivalent to that which would result from an addition to the height of Ross Dam. The power is to be received for 80 years, and delivery of power began in 1986. In addition to the direct costs of power under the agreement, the Department incurred costs of approximately $8.0 million in prior years related to the proposed addition and was obligated to help fund the Skagit Environmental Endowment Commission through four annual $1 million payments. These costs were deferred and are being amortized to purchase power expense over 35 years through 2035.

Power received and expenses under these and other long-term purchased power agreements at December 31, 2007 and 2006, are as follows:

| | 2007 Expense | 2006 Expense | 2007 Average Megawatts | 2006 Average Megawatts |
|---|---|---|---|---|
| Bonneville Block | $ 59,277,987 | $ 45,061,622 | 242.2 | 174.4 |
| Bonneville Slice | 116,513,042 | 109,656,740 | 411.3 | 451.1 |
| | 175,791,029 | 154,718,362 | 653.5 | 625.5 |
| Lucky Peak | 15,473,269 | 16,438,418 | 31.2 | 46.5 |
| British Columbia - High Ross Agreement | 13,395,061 | 13,386,727 | 35.8 | 36.1 |
| City of Klamath Falls | - | 12,006,483 | - | 11.4 |
| State Line Wind | 20,447,943 | 20,334,594 | 44.0 | 43.9 |
| Grant County Public Utility District | 1,360,686 | 1,348,433 | 2.9 | 2.8 |
| Grand Coulee Project Hydro Authority | 3,531,066 | 5,963,960 | 29.1 | 27.6 |
| Bonneville South Fork Tolt billing credit | (3,411,408) | (3,078,065) | - | - |
| British Columbia - Boundary Encroachment | - | - | 1.9 | 2.6 |
| Exchange energy - NCPA | 3,188,694 | 381,652 | 6.3 | 0.7 |
| Long-term purchased power booked out | (9,581,757) | (11,261,078) | (22.5) | (26.2) |
| | $ 220,194,583 | $ 210,239,486 | 782.2 | 770.9 |

***Power Exchanges***—Northern California Power Agency ("NCPA") and the Department executed a long-term Capacity and Energy Exchange Agreement in March 1993. The Department delivers a total of 90,580 MWh of exchange power to NCPA from June through October 15. NCPA returns a total of 91,584 MWh, or an option of 108,696 MWh under conditions specified in the contract at a 1.2:1 ratio of exchange power, from December through April. The agreement, which includes a financial settlement option, may be terminated beginning May 31, 2014 or annually on the same date thereafter with seven years' advance written notice by either party. The effect of implementing SFAS No. 153, *Exchanges of Nonmonetary Assets - an amendment of APB Opinion No. 29*, on January 1, 2006, was to increase accounts receivable by $3.7 million, revenues by $2.4 million, and expense by $0.2 million and to recognize deferred unrealized gain of $1.5 million.

***Estimated Future Payments Under Purchased Power and Transmission Contracts***—The Department's estimated payments under its contracts with Bonneville, the public utility districts, irrigation districts, Lucky Peak Project, British Columbia—High Ross Agreement, PacifiCorp Power Marketing, Inc. (now PPM Energy) and PacifiCorp for wind energy and net integration and exchange services, and for transmission with Bonneville, ColumbiaGrid, and others for the period from 2008 through 2065, undiscounted, are:

| Years Ending December 31 | Estimated Payments |
|---|---|
| 2008 | $ 245,567,142 |
| 2009 | 259,813,091 |
| 2010 | 261,996,849 |
| 2011(1) | 217,720,792 |
| 2012 | 93,204,910 |
| 2013–2017 | 485,795,077 |
| 2018–2022 | 451,692,200 |
| 2023–2027(2) | 213,507,254 |
| 2028–2032 | 33,138,332 |
| 2033–2037 | 33,556,166 |
| 2038–2042 | 9,535,584 |
| 2043–2065 | 20,458,113 |
| Total | $2,325,985,510 |

(1) Bonneville Block and Slice contract expires September 30, 2011.
(2) Bonneville transmission contract expires July 31, 2025.

The effects of changes that could occur to transmission as a result of FERC's implementation of the Federal Power Act as amended August 8, 2005, are not known and are not reflected in the estimated future payments except for inclusion of costs associated with ColumbiaGrid. The Department executed an agreement in January 2007 with ColumbiaGrid, a non-profit membership corporation formed to improve the operational efficiency, reliability, and planned expansion of the Northwest transmission grid.

Payments under these long-term power contracts totaled $230.8 million and $231.2 million in 2007 and 2006, respectively. Payments under these transmission contracts totaled $37.1 million and $37.5 million in 2007 and 2006, respectively.

## 11. OTHER ASSETS

Seattle City Council passed resolutions authorizing the debt financing and/or deferral of certain costs in accordance with SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. Unamortized charges for the deferral of contractual payments pursuant to the High Ross Agreement are being amortized to expense over 35 years through 2035 (see Note 10). Bonneville Slice contract true-up payments are deferred in the year invoiced and recognized as expense in the following year (See Note 10). Endangered Species Act costs are deferred and amortized to expense over the remaining license period (see Note 14).

Seattle City Council affirmed the Department's practice of deferring recognition of the effects of reporting the fair value of exchange contracts for rate making purposes and maintaining regulatory accounts to defer the accounting impact of these accounting adjustments, in Resolution 30942 adopted January 16, 2007 (see Note 10).

Underground electrical infrastructure costs for suburban jurisdictions will be recovered through rates from customers within the respective jurisdictions for a period of approximately 25 years after approval by the Seattle City Council. Programmatic conservation costs incurred by the Department and not funded by third parties are amortized to expense over 20 years. Capitalized relicensing and mitigation costs are deferred and amortized to expense over the remaining license period; or unamortized if incurred for future relicensing (see Note 14). The remaining components of other assets, excluding billable work in progress and real estate and conservation loans receivable, are being amortized to expense over 4 to 36 years.

Regulatory deferred charges and other assets net at December 31, 2007 and 2006, consisted of the following:

| | 2007 | 2006 |
|---|---|---|
| Regulatory deferred charges: | | |
| Deferred conservation costs—net | $ 141,583,364 | $ 138,077,119 |
| British Columbia - High Ross Agreement—net | 75,815,265 | 66,941,824 |
| Power exchange - regulatory deferred loss[1] | 762,634 | - |
| Bonneville Slice contract true-up payment[1] | - | 10,895,754 |
| Endangered Species Act—net[1] | 2,128,461 | 2,194,463 |
| | 2,891,095 | 13,090,217 |
| | 220,289,724 | 218,109,160 |
| Other deferred charges and assets—net: | | |
| Regulatory deferred charges—net | 2,891,095 | 13,090,217 |
| Suburban infrastructure long-term receivables | 21,559,438 | 3,494,000 |
| Puget Sound Energy interconnection and substation | 1,290,717 | 1,433,629 |
| Studies, surveys, and investigations | 675,269 | 967,578 |
| Skagit Environmental Endowment | 1,527,663 | 1,645,176 |
| South Fork Tolt mitigation—net | 372,716 | 263,827 |
| Real estate and conservation loans receivable | 34,129 | 280,540 |
| Unamortized debt expense | 6,497,250 | 7,244,364 |
| General work-in-process to be billed | 1,681,461 | 970,509 |
| Other | 251,117 | 180,652 |
| | 36,780,855 | 29,570,492 |
| Capitalized relicensing costs: | | |
| Skagit—net | 19,301,824 | 19,051,042 |
| Boundary—net | 21,615,063 | 9,801,135 |
| | 40,916,887 | 28,852,177 |
| Less: Regulatory deferred charges—net | (2,891,095) | (13,090,217) |
| Total Other Assets | $ 295,096,371 | $ 263,441,612 |

(1) Amounts comprise regulatory deferred charges, net in other assets.

## 12. DEFERRED CREDITS

Seattle City Council passed resolutions authorizing deferral of certain credits in accordance with SFAS No. 71. Payments received from Bonneville for qualified conservation augmentation programs are amortized to revenues over the life of the 10-year contract that expires September 30, 2011. Other deferred credits are amortized to revenues as earned, except unrealized or deferred gains from fair valuations that expire at contract completion and deposits that are returned to customers.

Regulatory deferred credits and other credits at December 31, 2007 and 2006, consisted of the following:

| | 2007 | 2006 |
|---|---|---|
| Regulatory deferred credits: | | |
| Bonneville conservation augmentation | $21,298,593 | $25,069,178 |
| Deferred Bonneville Slice true-up credit | 1,612,698 | - |
| Unrealized gains from fair valuations of short-term forward electric energy transactions | 191,192 | 6,489,208 |
| Exchange energy: regulatory deferred gain | 438,162 | 460,854 |
| | 23,540,645 | 32,019,240 |
| Other credits: | | |
| Deferred capital fees | 8,423,428 | 4,642,695 |
| Deferred revenues in lieu of rent for in-kind capital | 566,551 | 551,599 |
| Customer deposits—sundry sales | 2,060,472 | 1,242,282 |
| Deferred operations and maintenance revenues | 491,065 | 463,880 |
| Deferred revenues—other | 88,834 | 181,566 |
| | 11,630,350 | 7,082,022 |
| Total | $35,170,995 | $39,101,262 |

## 13. PROVISION FOR INJURIES AND DAMAGES

The Department is self-insured for casualty losses to its property, including for terrorism, environmental cleanup, and certain losses arising from third-party damage claims. The Department establishes liabilities for claims based on estimates of the ultimate cost of claims. The length of time for which such costs must be estimated varies depending on the nature of the claim. Actual claims costs depend on such factors as inflation, changes in doctrines of legal liability, damage awards, and specific incremental claim adjustment expenses. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates, which reflect recent settlements, claim frequency, industry averages, City-wide cost allocations, and economic and social factors. Liabilities for lawsuits, claims, and workers' compensation were discounted over a period of 15 to 16 years in 2007 and 2006 at the City's average annual rate of return on investments, which was 5.075% in 2007 and 3.966% in 2006. Liabilities for environmental cleanup and for casualty losses to the Department's property do not include claims that have been incurred but not reported and are not discounted due to uncertainty with respect to regulatory requirements and settlement dates.

The Lower Duwamish Waterway was designated a federal Superfund site by the EPA in 2001 for contaminated sediments. The City is one of four parties who signed an Administrative Order on Consent with the EPA and State Department of Ecology to conduct a remedial investigation/feasibility study to prepare a site remedy. The Department is considered a potentially responsible party for contamination in the Duwamish River due to land ownership or use of property located along the river. The liability for the Lower Duwamish Waterway site was estimated at $14.9 million and $8.9 million for 2007 and 2006, respectively.

The changes in the provision for injuries and damages at December 31, 2007 and 2006, are as follows:

| | 2007 | 2006 |
|---|---|---|
| Unpaid claims at January 1 | $22,197,296 | $18,387,556 |
| Payments | (6,930,388) | (3,834,006) |
| Incurred claims | 12,514,943 | 7,643,746 |
| Unpaid claims at December 31 | $27,781,851 | $22,197,296 |

The provision for injuries and damages included in current and noncurrent liabilities at December 31, 2007 and 2006, is as follows:

| | 2007 | 2006 |
|---|---|---|
| Noncurrent liabilities | $19,684,951 | $12,260,522 |
| Accounts payable and other | 8,096,900 | 9,936,774 |
| Total | $27,781,851 | $22,197,296 |

## 14. COMMITMENTS AND CONTINGENCIES

***Operating Leases***—In December 1994, the City entered into an agreement on behalf of the Department for a 10-year lease of office facilities in downtown Seattle commencing February 1, 1996. In early 1996, the City purchased the building in which these facilities are located, thus becoming the Department's lessor. This lease was extended through December 2006. Beginning in 2007, the Department made monthly lease payments to the City through the central cost allocation process, similar to all other payments for tenancy of city property. The Department also leases office equipment and smaller facilities for various purposes through long-term operating lease agreements. Expense under all leases totaled $6.9 million and $4.4 million in 2007 and 2006, respectively.

Minimum payments under the operating leases are:

| Year Ending December 31 | Minimum Payments |
|---|---|
| 2008 | $ 396,986 |
| 2009 | 170,185 |
| 2010 | 6,202 |
| 2011 | 68 |
| Total | $ 573,441 |

***2008 Capital Program***—The estimated financial requirement for the Department's 2008 program for capital improvement, conservation, and deferred operations and maintenance including required expenditures on assets owned by others is $247.7 million. The Department has substantial contractual commitments relating thereto.

***Application Process for New Boundary License***—The Department's FERC license for the Boundary Project expires on September 30, 2011. The Department intends to submit an application for a new license by October 2009. Application process costs are estimated at $57.6 million; as of December 31, 2007, $23.0 million had been expended and deferred. A new license may require additional mitigation efforts for endangered species, including water quality standards, the full extent of which is not known at this time. Cost projections for new license requirements are not included in the forecast.

***Skagit and South Fork Tolt Licensing Mitigation and Compliance***—In 1995, the FERC issued a license for operation of the Skagit hydroelectric facilities through April 30, 2025. On July 20, 1989, the FERC license for operation of the South Fork Tolt hydroelectric facilities through July 19, 2029, became effective. As a condition for both of these licenses, the Department has taken and will continue to take required mitigating and compliance measures. Total Skagit mitigation costs, excluding Endangered Species Act (ESA) costs, from the effective date until expiration of the federal operating license were estimated at December 31, 2007, to be $92.8 million, of which $62.9 million had been expended. South Fork Tolt costs were estimated at $4.2 million and $1.1 million was expended through 2007. Capital improvement, other deferred costs, and operations and maintenance costs are included in the estimates for both licenses.

***Endangered Species***—Several fish species that inhabit waters where hydroelectric projects are owned by the Department, or where the Department purchases power, have been listed under the Endangered Species Act (ESA) as threatened or endangered. On the Columbia River System, the National Oceanographic Atmospheric Administration (NOAA) Fisheries has developed a broad species recovery plan for listed salmon and steelhead, including recommendations for upstream and downstream fish passage requirements. These requirements include minimum flow targets for the entire Columbia Basin designed to maximize the survival of migrating salmon and steelhead. As a result, the Department's power generation at its Boundary Project is reduced in the fall and winter when the region experiences its highest sustained energy demand. The Boundary Project's firm capability is also reduced.

In Puget Sound, bull trout and Chinook salmon were listed as threatened species in 1999 by U.S. Fish and Wildlife Service (USFWS) and NOAA Fisheries, respectively. In 2007, NOAA Fisheries also listed steelhead as threatened in the Puget Sound. These ESA listings affect City Light's Skagit, Tolt, and Cedar Falls hydroelectric projects. Bull trout are present in the waters of Skagit and Cedar River projects including the reservoirs, and are present in the Tolt River downstream of Tolt Reservoir. Chinook salmon and steelhead are present downstream of all these projects. A draft recovery plan and proposed critical habitat for Puget Sound bull trout was issued by the U.S. Fish and Wildlife Service in July 2004. The Puget Sound bull trout recovery plan is expected to be finalized by the USFWS in 2008. Critical habitat was designated for bull trout by the USFWS, and includes the Skagit, Tolt, and Cedar Rivers downstream of the City Light's projects. The City of Seattle's reservoirs (Ross, Diablo, Gorge, Tolt, and Chester Morse) were not designated as critical habitat for bull trout. The final recovery plan for Puget Sound Chinook salmon was developed by regional stakeholders under the authority of NOAA Fisheries and was adopted by NOAA Fisheries in January 2007. Critical habitat has been designated for Puget Sound Chinook salmon, and includes that mainstream rivers downstream of the City's hydroelectric projects. The recovery planning process for Puget Sound steelhead will be initiated by NOAA Fisheries in 2008. While it is unknown how other listings will affect the Department's hydroelectric projects and operations, the Department is carrying out an ESA Early Action program in cooperation with agencies, tribes, local governments, and salmon groups for bull trout, Chinook salmon, and steelhead. The Department has been participating in the implementation of the Chinook salmon recovery plan on both regional and watershed levels. On the Cedar, the Department's activities are covered by a Habitat Conservation Plan that authorizes operations with regard to all listed species. In addition to the ESA, hydroelectric projects must also satisfy the requirements of the Clean Water Act in order to obtain a FERC license. Total costs through 2011, estimated at December 31, 2007, for the ESA were $34.7 million, of which $30.1 million had been expended.

***Project Impact Payments***—Effective November 1999, the Department committed to pay a total of $11.6 million and $7.8 million over 10 years ending in 2008 to Pend Oreille County and Whatcom County, respectively, for impacts on county governments from the operations of the Department's hydroelectric projects. The payments compensate the counties, and certain school districts and towns located in these counties, for loss of revenues and additional financial burdens associated with the projects. The Boundary Project located on the Pend Oreille River affects Pend Oreille County, and Skagit River hydroelectric projects affect Whatcom County. The combined impact compensation, including annual inflation factor of 3.1%, and retroactive payments totaled $1.3 million and $1.2 million to Pend Oreille County, and $0.9 million and $0.8 million to Whatcom County in 2007 and 2006, respectively.

***Streetlight Litigation***—In November 2003, the Washington Supreme Court invalidated a 1999 ordinance that included streetlight costs in the Department's general rate base for Seattle and Tukwila customers. As a result, the Department resumed billing the City for streetlight costs. In May 2004, further proceedings resulted in a ruling that required the Department to refund the amount collected from ratepayers since December 1999 attributable to streetlight costs. The ruling also required the City of Seattle general fund to repay the Department for the streetlight costs that should have been billed over the same period. The judgment was entered in October 2004, and required the City's general fund to pay approximately $23.9 million to the Department, an amount representing billings for streetlight services that should have been made to the City from late December 1999 through November 2003. In addition, the judgment required the City's general fund to pay approximately $222,000 to the Department for "loss of use" of funds, calculated as a percentage of the difference between the amount that should have been billed to the City and the amount paid by ratepayers for streetlight services. Payments were due on an installment schedule and received accordingly.

The Department was to refund to ratepayers in Seattle and Tukwila the amount of streetlight costs billed to them from January 2000 through November 2003. Gross refunds were estimated to be $21.5 million, plus $2.6 million to compensate ratepayers for "loss of use" of funds. Plaintiffs' attorney fees totaling $3.3 million and $0.7 million in administrative costs related to the refunds were deducted from the gross refund amount, leaving $20.0 million to be refunded to ratepayers. All refunds to ratepayers were paid by December 2006, and in December 2006, $3.5 million of remaining funds representing unclaimed streetlight refunds, was transferred to operations in accordance with the streetlight judgment.

Also in this partial judgment, the City's One Percent for Art Ordinance was declared invalid as applied to the Department. The City appealed this ruling. On December 19, 2005, the Washington Court of Appeals reversed the trial court's ruling that had declared the ordinance invalid as applied to the Department, but affirmed the trial court's ruling that art funded by the Department must have a "sufficiently close nexus" to the Department's purpose of providing electricity. Consequently in 2005, the Department recorded a reduction of $1.0 million in the One Percent for Art assets to comply with the court's ruling. During 2006, $1.1 million plus interest was received from the City's general fund.

In 2006, the State Supreme Court also has ruled that certain greenhouse gas offset contracts must be paid for by the City's general fund, although the Court reconsidered that decision.

In 2007, the streetlight litigation ended with (a) the State Supreme Court's denial of a motion for reconsideration of its decision that certain greenhouse gas offset contracts must be paid for by the City's general fund, rather than the Department and (b) the Court of Appeals award of approximately $1.3 million in attorney fees for causing the Department to change its ordinance governing certain utilities relocation expenses related to Sound Transit construction. The Department paid just over $1.0 million of the award and another city of Seattle department the remainder.

***Burns versus Seattle***—In July 2005, a class action lawsuit, *Burns v. Seattle,* was filed against the City and five suburban cities (Shoreline, Tukwila, Burien, SeaTac, and Lake Forest Park) that have franchise agreements with the Department for the provision of retail electric service. In each franchise, the Department agreed to make a payment in exchange for the suburban city's agreement not to establish its own municipal electric utility. The plaintiffs claimed that these payments were illegal "franchise fees" under RCW 35.21.860(1). In August 2007, the State Supreme Court upheld the payments, ending litigation.

***Energy Crisis Refund Litigation*****—**The Department is involved in various legal proceedings relating to the enormous price spikes in energy costs in California and the rest of the West Coast in 2000 and 2001.

- *California refund case, appeals and related litigation*—In the proceeding before the Federal Energy Regulatory Commission ("FERC"), various public and private California entities (the "California Parties") sought refunds in markets that had been created by the State of California. The Department had sold energy in one of these markets. The Department faced potential liability of approximately $6.5 million, subject to offsets. In 2001, FERC ordered refunds to the extent that actual energy prices exceeded rates that FERC determined to be "just and reasonable." On appeal, the Court of Appeals for the Ninth Circuit held that FERC has no authority to order governmental entities such as the Department to pay refunds. Following this ruling, the three major California investor-owned utilities sought refunds from the Department and other governmental entities in federal district court on a breach of contract theory. In March 2007, the court dismissed all claims. In April 2007, the three major California investor-owned utilities refilled their claims in state court. In December 2007, the trial court denied a request to dismiss the case.

- *Pacific Northwest refund case and appeal*—In the proceeding before FERC, various sellers of energy, including the Department, sought refunds on energy sales in the Pacific Northwest between May 2000 and June 2001. The Department's claims currently are in excess of $100.0 million. In 2003, FERC declined to grant refunds on the grounds that there was no equitable way to do so. In August 2007, the Ninth Circuit held that FERC had abused it discretion in denying all refund relief in the Pacific Northwest, and remanded the case to FERC for further proceedings. In December 2007, various sellers of energy filed petitions for rehearing in the Ninth Circuit. The Ninth Circuit has yet to rule on those petitions.

- *Grand Coulee Project Hydro Authority (GCPHA) Litigation*—The Department and the City of Tacoma (the "Cities") are in an ongoing contract dispute with the GCPHA over the amount of incentive payments due to the GCPHA under five identical long-term power purchase contracts. The Cities each are responsible for half of the incentive payments.

  The paid but disputed amount for contract years 2002 and 2003 (approximately $5.4 million) was submitted to an arbitrator in May 2006. Thereafter, the GCPHA claimed approximately $2.0 million for the 2004 contract year. The court prevented the GCPHA from collecting on that invoice while the arbitration proceeded, but required the Cities to deposit the 2004 disputed amount with the court. The GCPHA then claimed $3.4 million in incentive payments for the 2005 contract year, and the Cities again were ordered to deposit that amount with the court. The arbitrator ultimately decided against the Cities on the 2002 and 2003 contract years, and the court denied the Cities request for refunds. Based on this decision, the court released the disputed $5.4 million for contract years 2004 and 2005 to the GCPHA. The Cities have appealed the trial court's decision to confirm the arbitrator's decision.

***Other Contingencies*****—**In addition to those noted above, in the normal course of business, the Department has various other legal claims and contingent matters outstanding. The Department believes that any ultimate liability arising from these actions will not have a material adverse impact on the Department's financial position, operations, or cash flows.

## 15. SUBSEQUENT EVENTS

Global financial markets have endured extensive volatility over the first quarter of 2008 in response to the decline in the U.S. housing market since the summer of 2007. The result has been to the benefit of the City's cash pool, of which the Department has an equity in the pooled investments. The City's pool has strategically invested in internally researched and approved Asset Backed Commercial Paper (ABCP) programs that have provided above average yield to the pool and its participants. Given the short duration of the City's pool, the market's volatility has not had a significant impact on the market valuation of the City's investment holdings.

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