



# SALTON SEA FUNDING CORPORATION AND GUARANTORS

## **Combined Financial Statements and Independent Auditors' Report**

**As of December 31, 2012 and 2011 and for each of the**

**Three Years in the Period Ended December 31, 2012**

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## **INDEPENDENT AUDITORS' REPORT**

To the Board of Directors and Stockholder of  
Salton Sea Funding Corporation and Guarantors  
Omaha, Nebraska

We have audited the accompanying combined financial statements of Salton Sea Funding Corporation and Guarantors (the "Company"), which comprise the combined balance sheets as of December 31, 2012 and 2011, and the related combined statements of operations, comprehensive (loss) income, changes in owners' equity, and cash flows for each of the three years in the period ended December 31, 2012, and the related notes to the combined financial statements. The combined financial statements include the accounts of the companies disclosed in Note 1 to the combined financial statements. These companies are under common ownership and common management.

### **Management's Responsibility for the Combined Financial Statements**

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the companies' preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the companies' internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Salton Sea Funding Corporation and Guarantors as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in accordance with accounting principles generally accepted in the United States of America.

### **Report on Supplementary Combining Information**

Our audits were conducted for the purpose of forming an opinion on the combined financial statements taken as a whole. The supplementary combining information included in Exhibit A is presented for the purpose of additional analysis of the combined financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and is not a required part of the combined financial statements. This information is the responsibility of the Company's management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. Such information has been subjected to the auditing procedures applied in our audits of the combined financial statements and certain additional procedures, including comparing and reconciling such information

directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, such information is fairly stated in all material respects in relation to the combined financial statements as a whole.

/s/ Deloitte & Touche LLP

Omaha, Nebraska

March 26, 2013

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINED BALANCE SHEETS**  
(In thousands)

	<b>As of December 31,</b>	
<b>ASSETS</b>	<b>2012</b>	<b>2011</b>
Current assets:		
Cash and cash equivalents	\$ 7,233	\$ 3,101
Trade receivables	18,917	31,210
Inventories	24,169	27,173
Other current assets	888	1,064
Total current assets	51,207	62,548
Property, plant and equipment, net	488,865	520,912
Goodwill	86,992	86,992
Intangible assets, net	39,712	45,241
Other assets	352	482
<b>Total assets</b>	<b>\$ 667,128</b>	<b>\$ 716,175</b>
<b>LIABILITIES AND OWNERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 10,807	\$ 1,080
Major maintenance accruals	2,652	282
Accrued interest	630	734
Current portion of senior secured notes and bonds	14,664	16,614
Deferred income taxes	1,071	1,432
Other current liabilities	4,672	5,794
Total current liabilities	34,496	25,936
Senior secured notes and bonds	86,466	101,130
Due to affiliates	1,188	1,665
Deferred income taxes	114,273	137,327
Total liabilities	236,423	266,058
Commitments and contingencies (Note 8)		
Owners' equity	430,705	450,117
<b>Total liabilities and owners' equity</b>	<b>\$ 667,128</b>	<b>\$ 716,175</b>

The accompanying notes are an integral part of these combined financial statements.

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINED STATEMENTS OF OPERATIONS**

(In thousands)

	<b>Years Ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>Operating revenue</b>	<u>\$ 167,257</u>	<u>\$ 226,135</u>	<u>\$ 224,571</u>
<b>Operating costs and expenses:</b>			
Royalty, operating, general and administrative expense	132,184	118,188	111,640
Depreciation and amortization	<u>62,735</u>	<u>62,512</u>	<u>60,898</u>
Total operating costs and expenses	<u>194,919</u>	<u>180,700</u>	<u>172,538</u>
<b>Operating (loss) income</b>	<u>(27,662)</u>	<u>45,435</u>	<u>52,033</u>
<b>Other income (expense):</b>			
Interest expense	(8,518)	(9,796)	(11,897)
Interest and other income	<u>120</u>	<u>185</u>	<u>413</u>
Total other income (expense)	<u>(8,398)</u>	<u>(9,611)</u>	<u>(11,484)</u>
<b>(Loss) income before income tax (benefit) expense</b>	(36,060)	35,824	40,549
Income tax (benefit) expense	<u>(18,900)</u>	<u>(2,061)</u>	<u>80,747</u>
<b>Net (loss) income</b>	<u>\$ (17,160)</u>	<u>\$ 37,885</u>	<u>\$ (40,198)</u>

The accompanying notes are an integral part of these combined financial statements.

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME**

(In thousands)

	<b>Years Ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
Net (loss) income	\$ (17,160)	\$ 37,885	\$ (40,198)
Other comprehensive income (loss), net of tax-			
Unrecognized amounts on retirement benefits, net of tax of			
\$624, \$(441) and \$467	908	(661)	885
Comprehensive (loss) income	<u>\$ (16,252)</u>	<u>\$ 37,224</u>	<u>\$ (39,313)</u>

The accompanying notes are an integral part of these combined financial statements.

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINED STATEMENTS OF CHANGES IN OWNERS' EQUITY**  
(In thousands)

	<b>Owners' Equity</b>	<b>Accumulated Other Comprehensive (Loss) Income, Net</b>	<b>Total Equity</b>
<b>Balance, December 31, 2009</b>	\$ 516,093	\$ (1,108)	\$ 514,985
Net loss	(40,198)	-	(40,198)
Other comprehensive income	-	885	885
Distributions	(30,568)	-	(30,568)
<b>Balance, December 31, 2010</b>	445,327	(223)	445,104
Net income	37,885	-	37,885
Other comprehensive loss	-	(661)	(661)
Distributions	(32,211)	-	(32,211)
<b>Balance, December 31, 2011</b>	451,001	(884)	450,117
Net loss	(17,160)	-	(17,160)
Other comprehensive income	-	908	908
Distributions	(3,160)	-	(3,160)
<b>Balance, December 31, 2012</b>	<u>\$ 430,681</u>	<u>\$ 24</u>	<u>\$ 430,705</u>

The accompanying notes are an integral part of these combined financial statements.



**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINED STATEMENTS OF CASH FLOWS**

(In thousands)

	<b>Years Ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>Cash flows from operating activities:</b>			
Net (loss) income	\$(17,160)	\$ 37,885	\$(40,198)
Adjustments to reconcile net (loss) income to net cash flows from operating activities:			
Depreciation and amortization	62,735	62,512	60,898
Deferred income taxes	(24,039)	(12,467)	71,379
Amortization of deferred financing costs	130	171	267
Changes in other operating assets and liabilities:			
Trade receivables	12,293	94	(901)
Inventories	3,004	(3,073)	(276)
Due to affiliates, net	4,931	17,837	18,407
Other assets	176	130	227
Accounts payable and other liabilities	<u>10,988</u>	<u>(378)</u>	<u>(5,070)</u>
Net cash flows from operating activities	<u>53,058</u>	<u>102,711</u>	<u>104,733</u>
<b>Cash flows from investing activities:</b>			
Capital expenditures	(25,312)	(34,737)	(37,601)
Decrease in restricted cash	<u>-</u>	<u>-</u>	<u>75</u>
Net cash flows from investing activities	<u>(25,312)</u>	<u>(34,737)</u>	<u>(37,526)</u>
<b>Cash flows from financing activities:</b>			
Repayment of senior secured notes and bonds	(16,614)	(19,990)	(26,741)
Distributions	<u>(7,000)</u>	<u>(50,897)</u>	<u>(48,850)</u>
Net cash flows from financing activities	<u>(23,614)</u>	<u>(70,887)</u>	<u>(75,591)</u>
<b>Net change in cash and cash equivalents</b>	4,132	(2,913)	(8,384)
<b>Cash and cash equivalents at beginning of year</b>	<u>3,101</u>	<u>6,014</u>	<u>14,398</u>
<b>Cash and cash equivalents at end of year</b>	<u>\$ 7,233</u>	<u>\$ 3,101</u>	<u>\$ 6,014</u>
<b>Supplemental disclosure:</b>			
Interest paid	<u>\$ 8,492</u>	<u>\$ 9,757</u>	<u>\$ 11,809</u>
Income taxes paid	<u>\$ 5,139</u>	<u>\$ 10,838</u>	<u>\$ 12,170</u>
Non-cash investing transactions -			
Accounts payable related to property, plant, and equipment additions	<u>\$ 434</u>	<u>\$ 186</u>	<u>\$ -</u>

The accompanying notes are an integral part of these combined financial statements.

## **SALTON SEA FUNDING CORPORATION AND GUARANTORS NOTES TO COMBINED FINANCIAL STATEMENTS**

### **1. Organization and Operations**

Salton Sea Funding Corporation (“Funding Corporation”), which was formed on June 20, 1995, is a special purpose Delaware corporation and was organized for the sole purpose of acting as issuer of senior secured notes and bonds. On July 21, 1995, June 20, 1996 and October 31, 1998, Funding Corporation issued \$475.0 million, \$135.0 million and \$285.0 million, respectively, of separate series of Senior Secured Notes and Bonds (collectively, the “Securities”). Funding Corporation is a wholly owned subsidiary of Magma Power Company (“Magma”), which in turn is a wholly owned subsidiary of CE Generation, LLC (“CE Generation”). CE Generation is equally owned by MidAmerican Geothermal, LLC, an indirect wholly owned subsidiary of MidAmerican Energy Holdings Company (“MEHC”), and TransAlta (CE Gen) Investment USA Inc. (“TransAlta”), a wholly owned subsidiary of TransAlta Corporation. MEHC is a consolidated subsidiary of Berkshire Hathaway Inc.

The Salton Sea Guarantors (not a legal entity) consist of: (1) Salton Sea Power Generation Company, Salton Sea Power L.L.C. (“Salton Sea Power”), and Fish Lake Power LLC, together owning a 100% interest in five operating geothermal electric power generating plants located in the Imperial Valley of California commonly known as the Salton Sea I Project, the Salton Sea II Project, the Salton Sea III Project, the Salton Sea IV Project and the Salton Sea V Project (collectively, the “Salton Sea Projects”), (2) Salton Sea Brine Processing Company, and (3) CE Salton Sea Inc. (collectively, the “Salton Sea Guarantors”).

The Partnership Guarantors (not a legal entity) consist of: (1) Vulcan/BN Geothermal Power Company (“Vulcan”), Elmore Company (“Elmore”), CE Leathers Company (“Leathers”), Del Ranch Company (“Del Ranch”) and CE Turbo LLC (“CE Turbo”), each of which owns an operating geothermal power plant located in the Imperial Valley of California commonly known as the Vulcan Project, the Elmore Project, the Leathers Project, the Del Ranch Project and the CE Turbo Project, respectively (collectively, the “Partnership Projects”), (2) CalEnergy Operating Corporation (“CEOC”) and Vulcan Power Company (“VPC”), both 99% owned by Magma and 1% owned by Funding Corporation, (3) San Felipe Energy Company (“San Felipe”), Conejo Energy Company (“Conejo”), and Niguel Energy Company (“Niguel”), each 100% owned by CEOC, (4) VPC Geothermal LLC (“VPCG”), which is 100% owned by VPC, (5) Salton Sea Minerals Corp., (6) CalEnergy Minerals LLC (“CalEnergy Minerals”), and (7) CE Salton Sea Inc. (collectively, the “Partnership Guarantors”). VPC and VPCG collectively own 100% of the interests in Vulcan. CEOC, Niguel, San Felipe and Conejo collectively own 90% of the interests in each of Elmore, Leathers and Del Ranch, respectively. CE Salton Sea Inc. owns CE Turbo.

Magma owns all of the remaining 10% interests in each of the Elmore, Leathers and Del Ranch Projects. CEOC is entitled to receive from Magma, as payment for certain data and services provided by CEOC, all of the distributions Magma receives with respect to its 10% ownership interests in each of the Elmore, Leathers and Del Ranch Projects and Magma’s special distributions equal to 4.5% of total energy revenue from the Leathers Project. Given the assignment of these rights by Magma to CEOC, the 10% ownership interest in each of the Elmore, Leathers and Del Ranch Projects is reflected on the Combined Financial Statements of the Partnership Guarantors, the Salton Sea Guarantors and Funding Corporation.

Salton Sea Royalty Company (the “Royalty Guarantor”) is the beneficiary of an assignment of certain fees and royalties paid by the Elmore, Leathers and Del Ranch Projects (the “Royalty Projects”).

The Securities are payable from the proceeds of payments made of principal and interest on the secured project notes from the Salton Sea Guarantors, the Partnership Guarantors and the Royalty Guarantor (collectively, the “Guarantors”) to Funding Corporation. The Securities are also guaranteed on a joint and several basis by the Guarantors, each of which is an affiliate of Magma and Funding Corporation. Although the guarantees of the Partnership Guarantors and the Royalty Guarantor are limited to available cash flow (the guarantee of the Salton Sea Guarantors is not so limited), the obligations of each Guarantor under their respective secured project notes is not limited to available cash flow. Funding Corporation does not conduct any operations apart from those related to the issuance of the Securities.

The following table sets out information concerning the Salton Sea Projects and the Partnership Projects (collectively, the “Imperial Valley Projects”):

<u>Operating Project</u>	<u>Facility Net Capacity (MW)<sup>(1)</sup></u>	<u>Location</u>	<u>Power Purchase Agreement Expiration</u>	<u>Power Purchaser<sup>(2)</sup></u>
Salton Sea Projects:				
Salton Sea I Project	10	California	2017	Edison
Salton Sea II Project	20	California	2020	Edison
Salton Sea III Project	50	California	2019	Edison
Salton Sea IV Project	40	California	2026	Edison
Salton Sea V Project	<u>49</u>	California	2020	Riverside
Total Salton Sea Projects	<u>169</u>			
Partnership Projects:				
Vulcan Project	34	California	2016	Edison
Elmore Project	38	California	2018	Edison
Leathers Project	38	California	2019	Edison
Del Ranch Project	38	California	2018	Edison
CE Turbo Project	<u>10</u>	California	2029	APS
Total Partnership Projects	<u>158</u>			
Total Imperial Valley Projects	<u>327</u>			

(1) Facility Net Capacity represents the nominal net megawatt (“MW”) capacity for each facility. Actual MW may vary depending on operating and reservoir conditions and plant design.

(2) Southern California Edison Company (“Edison”); Riverside Public Utilities (“Riverside”); and Arizona Public Service (“APS”).

## 2. Summary of Significant Accounting Policies

### *Basis of Presentation*

The Combined Financial Statements include the accounts of Funding Corporation and the Guarantors (collectively, the “Company”) as Funding Corporation and the Guarantors are entities under common control and management. All transactions and accounts between and among Funding Corporation and the Guarantors have been eliminated. The Company has evaluated subsequent events through March 26, 2013, which is the date the Combined Financial Statements were available to be issued.

### *Use of Estimates in Preparation of Financial Statements*

The preparation of the Combined Financial Statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. These estimates include, but are not limited to, long-lived asset recovery; goodwill and intangible assets; accounting for contingencies; income taxes; and asset retirement obligations (“ARO”). Actual results may differ from estimates used in preparing the Combined Financial Statements.

### *Cash Equivalents and Restricted Cash*

Cash equivalents consist of funds invested in money market accounts and other investments with a maturity of three months or less when purchased. Cash and cash equivalents exclude amounts where availability is restricted by legal requirements, loan agreements or other contractual provisions. Restricted amounts are included in other current assets and other assets on the Combined Balance Sheets.

### *Inventories*

Inventories consist of spare parts and supplies and are stated at cost. The cost of large replacement parts is determined using the specific identification method. The cost of the remaining spare parts and supplies is determined using the average cost method.

### *Property, Plant and Equipment, Net*

#### *General*

The cost of additions and betterments are capitalized, while costs for replacements, maintenance, overhaul and well rework and repairs that do not improve or extend the useful lives of the related assets are expensed as incurred. Depreciation is computed by applying the straight-line method based on estimated useful lives.

#### *Asset Retirement Obligations*

The Company recognizes AROs when it has a legal obligation to perform removal activities upon retirement of an asset. The fair value of an ARO liability is recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made, and is added to the carrying amount of the associated asset, which is then depreciated over the remaining useful life of the asset. Subsequent to the initial recognition, the ARO liability is adjusted for any revisions to the original estimate of undiscounted cash flows (with corresponding adjustments to property, plant, and equipment) and for accretion of the ARO liability due to the passage of time. Given the renewable nature of the geothermal resource, the geothermal power plants and wells could be maintained and remain in production indefinitely. Due to the indeterminate removal date, the fair value of the associated liabilities on geothermal assets cannot currently be estimated and no amounts are recognized on the Combined Financial Statements.

### *Intangible Assets, Net*

The Company's intangible assets consist of acquired power purchase and royalty contracts and patented technology. Amortization is computed by applying the straight-line method based on the remaining contract periods.

### *Impairment of Long-Lived Assets*

The Company evaluates long-lived assets for impairment, including property, plant and equipment and intangible assets, when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable or the assets are being held for sale. Upon the occurrence of a triggering event, the asset is reviewed to assess whether the estimated undiscounted cash flows expected from the use of the asset plus the residual value from the ultimate disposal exceeds the carrying value of the asset. If the carrying value exceeds the estimated recoverable amounts, the asset is written down to the estimated fair value. Any resulting impairment loss is reflected on the Combined Statements of Operations.

### *Goodwill*

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations. The Company evaluates goodwill for impairment at least annually and completed its annual review as of October 31. When evaluating goodwill for impairment, the Company estimates the fair value of the reporting unit. If the carrying amount of a reporting unit, including goodwill, exceeds the estimated fair value, then the identifiable assets, including identifiable intangible assets, and liabilities of the reporting unit are estimated at fair value as of the current testing date. The excess of the estimated fair value of the reporting unit over the current estimated fair value of net assets establishes the implied value of goodwill. The excess of the recorded goodwill over the implied goodwill value is charged to earnings as an impairment loss. A significant amount of judgment is required in estimating the fair value of the reporting unit and performing goodwill impairment tests. The Company uses a variety of methods to estimate a reporting unit's fair value, principally discounted projected future net cash flows. Key assumptions used include, but are not limited to, the use of estimated future cash flows; multiples of earnings; and an appropriate discount rate. In estimating future cash flows, the Company incorporates current market information, as well as historical factors. As such, the determination of fair value incorporates significant unobservable inputs. During 2012, 2011 and 2010, the Company did not record any goodwill impairment.

### *Revenue Recognition and Significant Customers*

Operating revenue is derived primarily from the sale of electricity and is recorded based upon energy delivered and capacity provided at rates specified under long-term power purchase contracts. The majority of the contracts contain both fixed, or scheduled, and variable price periods. During the scheduled period, energy revenue is recognized at the lower of (i) amounts billable under the contract or (ii) an amount equal to the kilowatt hours (“kWh”) made available during the period multiplied by the estimated average revenue per kWh over the term of the contract. Energy revenue during the variable period and capacity revenue in all periods are recognized as earned.

87%, 89% and 90% of the Company’s sales of electricity were to Edison in 2012, 2011 and 2010, respectively. As of December 31, 2012 and 2011, trade receivables from Edison were \$15.9 million and \$28.9 million, respectively. Trade receivables are primarily uncollateralized receivables from long-term power purchase contracts and are stated at the outstanding principal amount, net of an estimated allowance for doubtful accounts. The allowance for doubtful accounts is based on the Company’s assessment of the collectibility of amounts owed to the Company by its customers. This assessment requires judgment regarding the ability of customers to pay or the outcome of any pending disputes. As of December 31, 2012 and 2011, there was no allowance for doubtful accounts.

### *Unamortized Financing Costs*

Financing costs incurred for the issuance of long-term debt are amortized over the term of the related financing using the effective interest method.

### *Income Taxes*

Funding Corporation is included in the consolidated United States federal income tax return and other state and federal jurisdictional returns, as required, with CE Generation and its affiliates. The Guarantors are comprised of a combination of corporations and limited liability companies. Those entities that are corporations are included in the consolidated income tax returns with their parent and affiliates. Income taxes for all taxable entities are provided on a separate return basis; however, these tax obligations will be remitted to the parent only to the extent cash flows are available after operating expenses and debt service. The income or loss of each limited liability company for income tax purposes, along with any associated tax credits, is the responsibility of the individual members. For these entities in which the tax attributes flow through to its owners, no income tax provision is reflected on the Combined Financial Statements.

Deferred income tax assets and liabilities are based on differences between the financial statement and income tax basis of assets and liabilities using estimated income tax rates expected to be in effect for the year in which the differences are expected to reverse. Changes in deferred income tax assets and liabilities that are associated with components of other comprehensive income (“OCI”) are charged or credited directly to OCI. Other changes in deferred income tax assets and liabilities are included as a component of income tax expense. Valuation allowances are established for certain deferred income tax assets where realization is not likely.

In determining the Company’s income taxes, management is required to interpret complex income tax laws and regulations. The Company’s income tax returns are subject to continuous examinations by federal, state and local income tax authorities that may give rise to different interpretations of these complex laws and regulations. Due to the nature of the examination process, it generally takes years before these examinations are completed and these matters are resolved. The Company recognizes the tax benefit from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the Combined Financial Statements from such a position are measured based on the largest benefit that is more-likely-than-not of being realized upon ultimate settlement. Although the ultimate resolution of the Company’s federal, state and local income tax examinations is uncertain, the Company believes it has made adequate provisions for these income tax positions. The aggregate amount of any additional income tax liabilities that may result from these examinations, if any, is not expected to have a material adverse impact on the Company’s combined financial results. The Company’s unrecognized tax benefits are primarily included in other long-term liabilities on the Combined Balance Sheets. Estimated interest and penalties, if any, related to uncertain tax positions are included as a component of income tax expense on the Combined Statements of Operations.

### *New Accounting Pronouncements*

In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-02, which amends FASB Accounting Standards Codification (“ASC”) Topic 220, “Comprehensive Income.” The amendments in this guidance require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income (“AOCI”) by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required by GAAP that provide additional detail about those amounts. This guidance is effective prospectively for annual reporting periods beginning after December 15, 2013. The Company is currently evaluating the impact of adopting this guidance on its Combined Financial Statements and disclosures included within Notes to Combined Financial Statements.

In June 2011, the FASB issued ASU No. 2011-05, which amends ASC Topic 220, “Comprehensive Income.” ASU No. 2011-05 provides an entity with the option to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Regardless of the option chosen, this guidance also requires presentation of items on the face of the financial statements that are reclassified from other comprehensive income to net income. This guidance does not change the items that must be reported in other comprehensive income, when an item of other comprehensive income must be reclassified to net income or how tax effects of each item of other comprehensive income are presented. This guidance is effective for interim and annual reporting periods beginning after December 15, 2011. In December 2011, the FASB issued ASU No. 2011-12, which also amends FASB ASC Topic 220 to defer indefinitely the ASU No. 2011-05 requirement to present items on the face of the financial statements that are reclassified from other comprehensive income to net income. ASU No. 2011-12 is also effective for interim and annual reporting periods beginning after December 15, 2011. The Company adopted this guidance on January 1, 2012 and elected the two separate but consecutive statements option.

In May 2011, the FASB issued ASU No. 2011-04, which amends FASB ASC Topic 820, “Fair Value Measurements and Disclosures.” The amendments in this guidance are not intended to result in a change in current accounting. ASU No. 2011-04 requires additional disclosures relating to fair value measurements categorized within Level 3 of the fair value hierarchy, including quantitative information about unobservable inputs, the valuation process used by the entity and the sensitivity of unobservable input measurements. Additionally, entities are required to disclose the level of the fair value hierarchy for assets and liabilities that are not measured at fair value in the balance sheet, but for which disclosure of the fair value is required. This guidance is effective for interim and annual reporting periods beginning after December 15, 2011. The Company adopted ASU No. 2011-04 on January 1, 2012. The adoption of this guidance did not have a material impact on the Company's disclosures included within Notes to Combined Financial Statements.

### **3. Property, Plant and Equipment, Net**

Property, plant and equipment, net consists of the following as of December 31 (in thousands):

	<u>Depreciable Life</u>	<u>2012</u>	<u>2011</u>
Power plants	5 to 30 years	\$ 955,502	\$ 945,541
Wells and resource development	2 to 30 years	<u>294,736</u>	<u>282,464</u>
Total operating assets		1,250,238	1,228,005
Accumulated depreciation		<u>(761,373)</u>	<u>(707,093)</u>
Property, plant and equipment, net		<u>\$ 488,865</u>	<u>\$ 520,912</u>

The Company replaced certain pipe and equipment with a remaining net book value of \$1.5 million, \$2.9 million and \$2.3 million for the years ended December 31, 2012, 2011, and 2010, respectively, which was charged to depreciation expense on the Combined Statements of Operations.

#### 4. Intangible Assets, Net

Intangible assets, net consists of the following as of December 31 (in thousands):

	Amortization Life	2012		2011	
		Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Power purchase and royalty contracts	4 to 30 years	\$ 216,935	\$ 188,660	\$ 216,935	\$ 185,062
Patented technology	24 years	<u>46,290</u>	<u>34,853</u>	<u>46,290</u>	<u>32,922</u>
Intangible assets, net		<u>\$ 263,225</u>	<u>\$ 223,513</u>	<u>\$ 263,225</u>	<u>\$ 217,984</u>

Amortization expense on acquired intangible assets was \$5.5 million for each of the years ended December 31, 2012, 2011 and 2010. The Company expects amortization expense on acquired intangible assets to be \$5.5 million for each of the three succeeding fiscal years and \$5.7 million for each 2016 and 2017.

#### 5. Senior Secured Bonds

Funding Corporation's long-term debt consists of 7.48% Series F Bonds due 2018 having an outstanding balance as of December 31, 2012 and 2011 of \$101.1 million and \$117.7 million, respectively.

The net revenues, equity distributions and royalties from the Imperial Valley Projects are used to pay principal and interest payments on outstanding senior secured bonds issued by Funding Corporation, the final series of which is scheduled to mature in November 2018. Funding Corporation debt is guaranteed by certain subsidiaries of Magma and secured by the capital stock of certain subsidiaries of CE Generation. The proceeds of Funding Corporation debt were loaned by Funding Corporation pursuant to loan agreements and notes (the "Imperial Valley Project Loans") to certain subsidiaries of Magma and used for the construction of certain Imperial Valley Projects, refinancing of certain indebtedness and other purposes. Debt service on the Imperial Valley Project Loans is used to repay debt service on Funding Corporation debt. The Imperial Valley Project Loans and the guarantees of Funding Corporation debt are secured by substantially all of the assets of the Guarantors, including the Imperial Valley Projects, and by the equity interests in the Guarantors. The Imperial Valley Project Loans also require Funding Corporation to maintain certain covenants. Funding Corporation was in compliance with these requirements at December 31, 2012.

In support of Funding Corporation's debt service requirements, a financial institution has issued a letter of credit for the account of TransAlta and a separate financial institution has issued a letter of credit for the account of MEHC. Each letter of credit was issued in the amount of \$12.6 million at December 31, 2012.

The annual repayments of Funding Corporation's debt for the years beginning January 1, 2013 and thereafter are as follows (in thousands):

2013	\$ 14,664
2014	17,337
2015	18,925
2016	20,370
2017	19,865
Thereafter	<u>9,969</u>
Total	<u>\$ 101,130</u>

## 6. Income Taxes

Income tax (benefit) expense consists of the following for the years ended December 31 (in thousands):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
<b>Current:</b>			
Federal	\$ 4,102	\$ 6,399	\$ 6,899
State	<u>1,037</u>	<u>4,007</u>	<u>2,469</u>
	<u>5,139</u>	<u>10,406</u>	<u>9,368</u>
<b>Deferred:</b>			
Federal	(17,993)	(12,070)	57,711
State	<u>(6,046)</u>	<u>(397)</u>	<u>13,668</u>
	<u>(24,039)</u>	<u>(12,467)</u>	<u>71,379</u>
Total	<u>\$ (18,900)</u>	<u>\$ (2,061)</u>	<u>\$ 80,747</u>

A reconciliation of the federal statutory income tax rate to the effective income tax rate applicable to income before income tax (benefit) expense is as follows for the years ended December 31:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Federal statutory income tax rate	35.0%	35.0%	35.0%
State income tax, net of federal income tax benefit	9.0	6.6	25.9
Percentage depletion	10.6	(20.0)	(17.8)
Energy tax credits	2.9	(10.3)	0.1
Change in valuation allowance	(6.5)	(13.8)	(10.6)
Production activities deduction	1.3	(3.5)	(2.3)
Interest expense adjustment	-	-	4.1
Deferred tax adjustment due to the Conversions	-	-	163.5
Other, net	<u>0.1</u>	<u>0.2</u>	<u>1.2</u>
Effective income tax rate	<u>52.4%</u>	<u>(5.8)%</u>	<u>199.1%</u>

Effective January 1, 2010, the Guarantors' elected to convert seven partnerships to corporations ("the Conversions"). The Conversions were effected for the purpose of optimizing the organizational structure of the Company, CE Generation and its affiliates under existing federal and state tax laws and regulations. By doing so, the Company, CE Generation and its affiliates are able to recognize certain benefits under existing federal and state tax laws which they were unable to realize under their previous form of organization. As of January 1, 2010 and consistent with its new form of organization, the Company incurred additional income tax expense of \$77.1 million related to the recognition of certain deferred income tax liabilities resulting from the Conversions.



The net deferred income tax liability consists of the following as of December 31 (in thousands):

	<u>2012</u>	<u>2011</u>
<b>Deferred income tax assets:</b>		
Net operating loss carryforwards	\$ 53,375	\$ 42,994
Federal and state credit carryforwards	35,493	33,824
Employee benefits	13	637
Accruals not currently deductible for tax purposes	<u>870</u>	<u>414</u>
Total deferred income tax assets	89,751	77,869
Valuation allowance	<u>(30,814)</u>	<u>(28,790)</u>
Total deferred income tax assets, net	<u>58,937</u>	<u>49,079</u>
<b>Deferred income tax liabilities:</b>		
Property related items	(158,100)	(169,425)
Intangible assets	<u>(16,181)</u>	<u>(18,413)</u>
Total deferred income tax liabilities	<u>(174,281)</u>	<u>(187,838)</u>
Net deferred income tax liability	<u>\$ (115,344)</u>	<u>\$ (138,759)</u>
<b>Reflected as:</b>		
Current liability	\$ (1,071)	\$ (1,432)
Non-current liability	<u>(114,273)</u>	<u>(137,327)</u>
	<u>\$ (115,344)</u>	<u>\$ (138,759)</u>

As of December 31, 2012, the Company has available federal carryforwards, principally for net operating losses, totaling \$47.4 million and state carryforwards totaling \$6.0 million, which expire at various intervals between 2013 and 2024. As of December 31, 2012, the Company also has available federal energy tax credit carryforwards totaling \$25.4 million that begin to expire in 2020 unless previously utilized. Additionally, the Company has available federal alternative minimum tax credit carryforwards totaling \$8.8 million, state alternative minimum tax credit carryforwards totaling \$1.1 million and state enterprise zone credit carryforwards totaling \$0.2 million, which do not expire and will carryforward indefinitely until utilized.

The United States Internal Revenue Service has closed examination of the Company's income tax returns through 2009. In addition, state jurisdictions have closed examination of the Company's income tax returns through at least 2007.

## 7. Fair Value Measurements

The carrying value of the Company's cash, certain cash equivalents, receivables, payables and accrued liabilities approximates fair value because of the short-term maturity of these instruments. The Company uses a three level hierarchy for determining fair value and a financial asset or liability classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. The Company's long-term debt is carried at cost on the Combined Financial Statements. The fair value of the Company's long-term debt is a Level 2 fair value measurement and has been estimated based upon quoted market prices. The following table presents the carrying value and estimated fair value of the Company's long-term debt as of December 31 (in thousands):

	<u>2012</u>		<u>2011</u>	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Senior secured notes and bonds	<u>\$ 101,130</u>	<u>\$ 104,753</u>	<u>\$ 117,744</u>	<u>\$ 131,848</u>

## **8. Commitments and Contingencies**

### *The California Power Exchange*

In January 2001, the California Power Exchange declared bankruptcy. As a result, Salton Sea Power and CE Turbo did not receive payment for power sold to El Paso Merchant Energy Company (“EPME”) under certain transaction agreements during December 2000 and January 2001 of \$3.8 million (the “PX Receivable”). Salton Sea Power and CE Turbo established an allowance for doubtful accounts for this balance as of December 31, 2003. On September 29, 2004, Salton Sea Power and CE Turbo entered into separate Transfer of Claims Agreements (the “Transfer of Claims Agreements”), pursuant to which Salton Sea Power and CE Turbo received an aggregate of \$3.7 million in exchange for transferring the rights to receive payment on the PX Receivable to TransAlta and MEHC. As a result of the transaction, Salton Sea Power and CE Turbo wrote-off the PX Receivable and the related allowance for doubtful accounts and recorded a \$3.8 million current liability to reflect the collection risk retained under the Transfer of Claims Agreements. Pursuant to the Transfer of Claims Agreements, to the extent that the PX Receivable becomes uncollectible, Salton Sea Power and CE Turbo can be required to pay the PX Receivable, plus interest, to MEHC and TransAlta. EPME informed Salton Sea Power and CE Turbo that, on July 6, 2007, it received a distribution in connection with a settlement involving its claims in the California Power Exchange bankruptcy proceeding. In August 2007, EPME paid \$2.4 million, or \$1.2 million each to MEHC and TransAlta, in connection with the bankruptcy proceeding distribution that EPME received on their behalf. Accordingly, Salton Sea Power and CE Turbo reduced their collective liability by \$2.4 million to \$1.4 million.

### *Environmental Laws and Regulations*

The Company is subject to federal, state and local laws and regulations regarding water quality, climate change, hazardous and solid waste disposal and other environmental matters that have the potential to impact the Company’s current and future operations. The Company believes it is in material compliance with all applicable laws and regulations.

### *Accrued Environmental Costs*

The Company is fully or partly responsible for environmental remediation at various contaminated sites, including sites that are or were part of the Company’s operations and sites owned by third parties. The Company accrues environmental remediation expenses when the expenses are believed to be probable and can be reasonably estimated. The quantification of environmental exposures is based on many factors, including changing laws and regulations, advancements in environmental technologies, the quality of available site-specific information, site investigation results, expected remediation or settlement timelines, the Company’s proportionate responsibility, contractual indemnities and coverage provided by insurance policies. The liability recorded as of December 31, 2012 and 2011 was \$0.3 million and \$1.4 million, respectively, and is included in other current liabilities on the Combined Balance Sheets. Environmental remediation liabilities that separately result from the normal operation of long-lived assets and that are legal obligations associated with the retirement of those assets are separately accounted for as asset retirement obligations.

## **9. Related Party Transactions**

Funding Corporation made equity distributions of \$3.2 million, \$32.2 million and \$30.6 million for the years ended December 31, 2012, 2011 and 2010, respectively. The equity distributions represent the operating losses and capital expenditures of certain Guarantors previously funded by amounts held in the revenue account of Funding Corporation and amounts previously transferred to Magma pursuant to the terms and conditions of the debt of Funding Corporation.

Pursuant to the Amended and Restated Easement Grant Deed and Agreement Regarding Rights for Geothermal Development dated February 23, 1994, as amended, the Salton Sea Guarantors acquired from Magma Land I, a wholly-owned subsidiary of Magma, rights to extract geothermal brine from the geothermal lease rights property which is necessary to operate the Salton Sea Guarantors’ power generation facilities in return for 5% of all electricity revenue received by the Salton Sea Guarantors. The amounts expensed for the years ended December 31, 2012, 2011 and 2010 were \$4.3 million, \$5.5 million and \$5.5 million, respectively.

Pursuant to the Easement Grant Deeds and Agreements Regarding Rights for Geothermal Development dated March 14, 1988 and August 15, 1988, the Partnership Guarantors acquired from Magma rights to extract geothermal brine from the geothermal lease rights property which is necessary to operate the Leathers, Del Ranch and Elmore Projects in return for

17.333%, on a pro rata basis, of all energy revenue received by each project. The amounts expended for the years ended December 31, 2012, 2011 and 2010 were \$6.7 million, \$11.3 million and \$11.1 million, respectively.

The Company participates in the MidAmerican Energy Company Retirement Plan and the MidAmerican Energy Company Welfare Benefit Plan, each of which is sponsored by MidAmerican Energy Company (“MEC”), an indirect wholly-owned subsidiary of MEHC. The Company’s contributions to the various plans were \$1.2 million, \$1.5 million and \$1.6 million for the years ended December 31, 2012, 2011 and 2010, respectively. The portion of accumulated other comprehensive income attributable to the Company has been allocated from MEC in accordance with the intercompany administrative service agreement.

Pursuant to the Administrative Services Agreement dated April 1, 1993 with Magma (the “Magma Services Agreement”), Magma will provide administrative and management services to the Salton Sea Guarantors, excluding the Salton Sea IV Project and the Salton Sea V Project. Fees payable to Magma amount to 3% of all electricity revenue. The amounts expended for the years ended December 31, 2012, 2011 and 2010 were \$1.1 million, \$1.6 million and \$1.6 million, respectively

Pursuant to the Magma Services Agreement, Magma has agreed to pay CEOC all equity cash flows and certain royalties payable by the Partnership Guarantors in exchange for providing data and services to Magma. As security for the obligations of Magma under the Magma Services Agreement, Magma has collaterally assigned to CEOC its rights to such equity cash flows and certain royalties. The assignment of such rights has been reflected on the Combined Financial Statements of the Company.

**10. Components of Accumulated Other Comprehensive Income (Loss), Net**

The following table shows the change in accumulated other comprehensive income (loss) attributable to Salton Sea Funding Corporation by each component of other comprehensive loss, net of applicable income taxes, for the year ended December 31, 2012 (in thousands):

	Unrecognized Amounts on Retirement Benefits
<b>Balance, December 31, 2011</b>	\$ (884)
Other comprehensive loss	<u>908</u>
<b>Balance, December 31, 2012</b>	<u><u>\$ 24</u></u>

## Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's discussion and analysis of certain significant factors that have affected the combined financial condition and results of operations of Salton Sea Funding Corporation ("Funding Corporation") and the Guarantors (collectively, the "Company") during the periods included herein. Explanations include management's best estimate of the impact of weather and other factors. This discussion should be read in conjunction with the Company's historical Combined Financial Statements and Notes to Combined Financial Statements included elsewhere in this report. The Company's actual results in the future could differ significantly from the historical results.

The Guarantors consist of the following legal entities:

- *Salton Sea Guarantors* - Salton Sea Brine Processing Company, Salton Sea Power Generation Company, Salton Sea Power L.L.C., and Fish Lake Power LLC, each of which have an ownership interest in one or more of five operating geothermal power plants in the Imperial Valley of California commonly known as the Salton Sea I Project, Salton Sea II Project, Salton Sea III Project, Salton Sea IV Project and Salton Sea V Project (collectively, the "Salton Sea Projects"), and CE Salton Sea Inc.
- *Partnership Guarantors* - Vulcan/BN Geothermal Power Company ("Vulcan"), Elmore Company ("Elmore"), CE Leathers Company ("Leathers"), Del Ranch Company ("Del Ranch"), and CE Turbo LLC ("CE Turbo"), each of which owns an operating geothermal power plant located in the Imperial Valley of California commonly known as the Vulcan Project, the Elmore Project, the Leathers Project, the Del Ranch Project and the CE Turbo Project (collectively, the "Partnership Projects"), CalEnergy Minerals LLC, Salton Sea Minerals Corp., CE Salton Sea Inc., CalEnergy Operating Corporation, Vulcan Power Company, San Felipe Energy Company, Conejo Energy Company, Niguel Energy Company, and VPC Geothermal LLC.
- *Royalty Guarantor* - Salton Sea Royalty Company.

The Salton Sea Projects and the Partnership Projects are collectively known as the Imperial Valley Projects. Refer to Exhibit B, included herein, for additional information regarding the legal organization and ownership structure of the Company.

## Forward-Looking Statements

From time to time, the Company may make forward-looking statements that involve judgments, assumptions and other uncertainties beyond the control of the Company or any of its subsidiaries individually. These forward-looking statements may include, among others, statements concerning revenue and cost trends, cost reduction strategies and anticipated outcomes, pricing strategies, changes in the utility industry, planned capital expenditures, financing needs and availability, statements of the Company's expectations, beliefs, future plans and strategies, anticipated events or trends and similar comments concerning matters that are not historical facts. These types of forward-looking statements are based on current expectations and involve a number of known and unknown risks and uncertainties that could cause the actual results and performance of the Company to differ materially from any expected future results or performance, expressed or implied, by the forward-looking statements. The Company has identified important factors that could cause actual results to differ materially from those expectations, including weather effects on revenues and other operating uncertainties, uncertainties relating to economic and political conditions and uncertainties regarding the impact of regulations, changes in government policy and competition. The Company undertakes no obligation to update forward-looking statements, whether as a result of new information, future events or otherwise. The foregoing factors should not be construed as exclusive.

## Results of Operations

### *Operating Revenue*

The capacity factor for a particular project is determined by dividing the total quantity of electricity sold by the product of the project's capacity and the total hours in the year. Refer to Note 1 of Notes to Combined Financial Statements for the net capacity of each facility. Each plant possesses an operating margin, which allows for production in excess of a facility's net capacity. Utilization of this operating margin is based upon a variety of factors and can be expected to vary throughout the year under normal operating conditions. The amount of revenues received by the projects is affected by the extent to which they are able to operate and generate electricity. Accordingly, the capacity and capacity factor figures provide information on operating performance that has affected the revenues received by the projects.

For discussion of the Company's long-term power sales agreement with Southern California Edison Company ("Edison"), refer to the "Price and Credit Risks" section included in this report.

The following represents operating revenue (in millions), aggregate capacity and electricity production of the Imperial Valley Projects:

	<b>Years Ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
Operating revenue	\$167.3	\$226.1	\$224.6
Overall capacity factor	81.3%	91.2%	90.7%
Megawatt hours produced	2,330,500	2,606,800	2,593,200
Facility net capacity (MW) (weighted average)	326.4	326.4	326.4

Operating revenue for 2012 decreased \$58.8 million, or 26.0%, from 2011 primarily due to the following:

- \$41.5 million decrease due to lower energy rates at certain Imperial Valley Projects.
- \$17.3 million decrease due to a 10.6% decrease in energy production. The energy production decrease primarily resulted from equipment repairs and transmission line outages at certain Imperial Valley Projects in 2012.

Operating revenue for 2011 increased \$1.5 million, or 0.7%, from 2010 primarily due to the following:

- \$1.2 million increase due to higher energy rates at certain Imperial Valley Projects.
- \$0.3 million increase due to a 0.5% increase in energy production. The energy production increase primarily resulted from less downtime for equipment repairs at the CE Turbo Project.

### *Royalty, Operating, General and Administrative Expense*

Royalty, operating, general and administrative expense increased \$14.0 million, or 11.8%, to \$132.2 million for 2012 from \$118.2 million for 2011 primarily due to higher maintenance costs at certain Imperial Valley Projects.

Royalty, operating, general and administrative expense increased \$6.6 million, or 5.9%, to \$118.2 million for 2011 from \$111.6 million for 2010 primarily due to the scope and timing of scheduled maintenance.

### *Depreciation and Amortization*

Depreciation and amortization increased \$0.2 million, or 0.3%, to \$62.7 million for 2012 from \$62.5 million for 2011 primarily due to the timing of capital replacement projects and related asset abandonments.

Depreciation and amortization increased \$1.6 million, or 2.7%, to \$62.5 million for 2011 from \$60.9 million for 2010 primarily due to the timing of capital replacement projects and related asset abandonments.

### *Interest Expense*

Interest expense decreased \$1.3 million to \$8.5 million for 2012 compared to 2011 and \$2.1 million to \$9.8 million for 2011 compared to 2010. The decreases were due to lower outstanding debt balances.

### *Interest and Other Income*

Interest and other income decreased \$0.1 million to \$0.1 million for 2012 compared to 2011 and \$0.2 million to \$0.2 million for 2011 compared to 2010. The decreases were due to lower rates on invested balances.

### *Income Tax (Benefit) Expense*

Income tax benefit increased \$16.8 million to \$18.9 million for 2012 compared to 2011. The effective tax rates were 52.4% and (5.8)% in 2012 and 2011, respectively. The changes in income tax benefit and the effective tax rate were primarily due to the change in pre-tax income, including the limitations on depletion, as well as the settlement of the 2005-2009 Federal income tax audit and the resolution of various state tax matters in 2011.

Income tax (benefit) expense decreased \$82.8 million to a benefit of \$(2.1) million for 2011 compared to 2010. The effective tax rates were (5.8)% and 199.1% in 2011 and 2010, respectively. The changes in income tax (benefit) expense and the effective tax rate were primarily due to the recognition of certain deferred income tax liabilities in 2010 resulting from the conversion of seven partnerships to corporations (the "Conversions") effective January 1, 2010, as well as the settlement of the 2005-2009 Federal income tax audit and the resolution of various state tax matters in 2011.

The Conversions were effected for the purpose of optimizing the organizational structure of the Company, CE Generation and its affiliates under existing federal and state tax laws and regulations. By doing so, the Company, CE Generation and its affiliates are able to recognize certain benefits under existing federal and state tax laws which they were unable to realize under their previous form of organization. Following January 1, 2010 and consistent with its new form of organization, the Company incurred additional income tax expense of \$77.1 million related to the recognition of certain deferred income tax liabilities resulting from the Conversions. Due to the Company's inclusion in the consolidated United States federal tax return and other state and federal jurisdictional returns with CE Generation and its affiliates, the Conversions had no cash impact on the Company.

### Liquidity and Capital Resources

The Company's cash and cash equivalents were \$7.2 million as of December 31, 2012, compared to \$3.1 million as of December 31, 2011.

Net cash flows from operating activities for 2012 and 2011 were \$53.1 million and \$102.7 million, respectively. The decrease was primarily due to decreased revenues and higher maintenance costs at certain Imperial Valley Projects.

Net cash flows from operating activities for 2011 and 2010 were \$102.7 million and \$104.7 million, respectively. The decrease was primarily due to the scope and timing of scheduled maintenance activities at certain Imperial Valley Projects.

Net cash flows from investing activities for 2012 and 2011 were \$(25.3) million and \$(34.7) million, respectively. The decrease was due to lower capital expenditures related primarily to the timing of drilling projects.

Net cash flows from investing activities for 2011 and 2010 were \$(34.7) million and \$(37.5) million, respectively. The decrease was due to lower capital expenditures related primarily to the timing of drilling projects.

Forecasted capital expenditures for 2013 are approximately \$34 million. Capital expenditure needs are reviewed regularly by management and may change significantly as a result of such reviews. The Company expects to meet these capital expenditure requirements with cash flows from operations.

Net cash flows from financing activities for 2012 and 2011 were \$(23.6) million and \$(70.9) million, respectively. The decrease was due to lower distributions and scheduled debt payments in 2012.

Net cash flows from financing activities for 2011 and 2010 were \$(70.9) million and \$(75.6) million, respectively. The decrease was due to lower scheduled debt payments.

Funding Corporation has been informed by MidAmerican Geothermal, LLC and TransAlta of their intent to contribute capital for the purpose of assisting with Funding Corporation's scheduled second quarter 2013 debt service payment.

### Contractual Obligations

The Company has contractual cash obligations that may affect its combined financial condition. The following table summarizes the Company's material contractual cash obligations as of December 31, 2012 (in thousands):

	<b>Payments Due by Period</b>				<b>Total</b>
	<b>2013</b>	<b>2014- 2015</b>	<b>2016- 2017</b>	<b>2018</b>	
Long-term debt	\$ 14,664	\$ 36,262	\$ 40,235	\$ 9,969	\$ 101,130
Interest payments on long-term debt <sup>(1)</sup>	<u>7,285</u>	<u>10,953</u>	<u>5,231</u>	<u>559</u>	<u>24,028</u>
Total contractual cash obligations	<u>\$ 21,949</u>	<u>\$ 47,215</u>	<u>\$ 45,466</u>	<u>\$ 10,528</u>	<u>\$ 125,158</u>

<sup>(1)</sup> Not reflected on the Combined Balance Sheets.

The Company has other types of commitments that arise primarily from letters of credit, which have not been included in the above table because the amount and timing of the cash payments are not certain.

In support of Funding Corporation's debt service requirements, a financial institution has issued a letter of credit for the account of TransAlta and a separate financial institution has issued a letter of credit for the account of MEHC. Each letter of credit was issued in the amount of \$12.6 million at December 31, 2012.

### Environmental Laws and Regulations

The Company is subject to federal, state and local laws and regulations regarding water quality, climate change, hazardous and solid waste disposal and other environmental matters that have the potential to impact the Company's current and future operations. In addition to imposing continuing compliance obligations, these laws and regulations provide regulators with the authority to levy substantial penalties for noncompliance including fines, injunctive relief and other sanctions. These laws and regulations are administered by the Environmental Protection Agency ("EPA") and various other state and local agencies. All such laws and regulations are subject to a range of interpretation, which may ultimately be resolved by the courts. Environmental laws and regulations continue to evolve, and the Company is unable to predict the impact of the changing laws and regulations on its operations and combined financial results. The Company believes it is in material compliance with all applicable laws and regulations. Refer to Note 8 of Notes to Combined Financial Statements included elsewhere in this report for additional information regarding certain environmental laws and regulations affecting the Company.

### *Climate Change*

While significant measures to regulate greenhouse gas ("GHG") emissions at the federal level were considered by the United States Congress in 2010, comprehensive climate change legislation has not been adopted. Regulation of GHG emissions under various provisions of the Clean Air Act has continued since the EPA's December 2009 findings that GHG emissions threaten public health and welfare.

In May 2010, the EPA issued the GHG "Tailoring Rule" to address permitting requirements for GHG after determining that GHG are subject to regulation and would trigger Clean Air Act permitting requirements for stationary sources beginning in January 2011. Numerous lawsuits have been filed on both the EPA's endangerment finding and the Tailoring Rule in the D.C. Circuit. In June 2012, the D.C. Circuit dismissed the challenges to the rules and upheld the EPA's actions. Petitions for rehearing by the full D.C. Circuit were filed, which were denied in December 2012.

In April 2012, the EPA proposed New Source Performance Standards for GHG at new fossil-fueled generating facilities at an emissions rate of 1,000 pounds per MWh, which are expected to be finalized in the first half of 2013. The EPA is also under a consent decree to establish GHG emissions performance standards for existing and modified sources.

International discussions regarding climate change continue to be held periodically with the expiration of the Kyoto Protocol in December 2012. During the December 2012 18th Conference of the Parties in Doha, Qatar, the parties to the Kyoto Protocol agreed to a Kyoto Protocol 2 that will involve more than 25 nations (mainly the European Union and Australia), comprising about 15% of global GHG emissions, to run from 2013 to 2020.

While the debate continues at the federal and international level over the direction of climate change policy, several states have continued to implement state-specific laws or regional initiatives to report or mitigate GHG emissions. In addition, governmental, non-governmental and environmental organizations have become more active in pursuing climate change related litigation under existing laws.

In September 2009, the EPA issued its final rule regarding mandatory reporting of GHG (“GHG Reporting”) beginning January 1, 2010. Under GHG Reporting, suppliers of fossil fuels, manufacturers of vehicles and engines, and facilities that emit 25,000 metric tons or more per year of GHG are required to submit annual reports to the EPA.

New federal, regional, state and international accords, legislation, regulation, or judicial proceedings limiting GHG emissions could have a material adverse impact on the Company, the United States and the global economy. Companies and industries with higher GHG emissions, such as utilities with significant coal-fueled generating facilities, will be subject to more direct impacts and greater financial and regulatory risks. The impact is dependent on numerous factors, none of which can be meaningfully quantified at this time. These factors include, but are not limited to, the magnitude and timing of GHG emissions reduction requirements; the design of the requirements; the cost, availability and effectiveness of emissions control technology; the price, distribution method and availability of offsets and allowances used for compliance; government-imposed compliance costs; and the existence and nature of incremental cost recovery mechanisms.

The impact of events or conditions caused by climate change, whether from natural processes or human activities, could vary widely, from highly localized to worldwide, and the extent to which a utility's operations may be affected is uncertain. Climate change may cause physical and financial risk through, among other things, sea level rise, changes in precipitation and extreme weather events. Consumer demand for energy may increase or decrease, based on overall changes in weather and as customers promote lower energy consumption through the continued use of energy efficiency programs or other means.

#### *Renewable Portfolio Standards*

The California renewable portfolio standard (“RPS”) requires all California retail sellers to procure an average of 20% of retail load from renewable resources by December 31, 2013, 25% by December 31, 2016 and 33% by December 31, 2020 and each year thereafter. The Company is not considered a retail seller in California and is not subject to the California RPS requirements. However, the Company’s Imperial Valley Projects may find more favorable market conditions for their output as a result of the California RPS.

#### Inflation

Historically, overall inflation and changing prices have not had a significant impact on the Company’s combined financial results.

#### Off-Balance Sheet Arrangements

The Company does not have any obligations which meet the definition of an off-balance sheet arrangement and which have or are reasonably likely to have a material effect on the Combined Financial Statements.

#### New Accounting Pronouncements

For a discussion of new accounting pronouncements affecting the Company, refer to Note 2 of Notes to Combined Financial Statements included elsewhere in this report.

#### Critical Accounting Estimates

Certain accounting measurements require management to make estimates and judgments concerning transactions that will be settled several years in the future. Amounts recognized on the Combined Financial Statements based on such estimates



involve numerous assumptions subject to varying and potentially significant degrees of judgment and uncertainty and will likely change in the future as additional information becomes available. The following critical accounting estimates are impacted significantly by the Company's methods, judgments and assumptions used in the preparation of the Combined Financial Statements and should be read in conjunction with the Company's Summary of Significant Accounting Policies included in Note 2 of Notes to Combined Financial Statements included elsewhere in this report.

#### *Impairment of Long-Lived Assets and Goodwill*

The Company evaluates long-lived assets for impairment, including property, plant and equipment and intangible assets, when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable or the assets are being held for sale. Upon the occurrence of a triggering event, the asset is reviewed to assess whether the estimated undiscounted cash flows expected from the use of the asset plus the residual value from the ultimate disposal exceeds the carrying value of the asset. If the carrying value exceeds the estimated recoverable amounts, the asset is written down to the estimated fair value. Any resulting impairment loss is reflected on the Combined Statements of Operations.

The estimate of cash flows arising from the future use of the asset that are used in the impairment analysis requires judgment regarding what the Company would expect to recover from the future use of the asset. Changes in judgment that could significantly alter the calculation of the fair value or the recoverable amount of the asset may result from significant changes in the business climate, management's plans, legal factors, market price of the asset, the use of the asset or the physical condition of the asset, future market prices, load growth, competition and many other factors over the life of the asset. Any resulting impairment loss is highly dependent on the underlying assumptions and could significantly affect the Company's results of operations.

The Company's Combined Balance Sheet as of December 31, 2012 includes goodwill of acquired businesses of \$87.0 million. The Company evaluates goodwill for impairment at least annually and completed its annual review as of October 31. Additionally, no indicators of impairment were identified as of December 31, 2012. A significant amount of judgment is required in estimating the fair value of the reporting unit and performing goodwill impairment tests. The Company uses a variety of methods to estimate a reporting unit's fair value, principally discounted projected future net cash flows. Key assumptions used include, but are not limited to, the use of estimated future cash flows; multiples of earnings; and an appropriate discount rate. Estimated future cash flows are impacted by, among other factors, growth rates, changes in regulations and rates, ability to renew contracts and estimates of future commodity prices. In estimating future cash flows, the Company incorporates current market information, as well as historical factors.

#### *Income Taxes*

In determining the Company's income taxes, management is required to interpret complex income tax laws and regulations. The Company's income tax returns are subject to continuous examinations by federal, state and local income tax authorities that may give rise to different interpretations of these complex laws and regulations. Due to the nature of the examination process, it generally takes years before these examinations are completed and these matters are resolved. The Company recognizes the tax benefit from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the Combined Financial Statements from such a position are measured based on the largest benefit that is more-likely-than-not of being realized upon ultimate settlement. Although the ultimate resolution of the Company's federal, state and local income tax examinations is uncertain, the Company believes it has made adequate provisions for these income tax positions. The aggregate amount of any additional income tax liabilities that may result from these examinations, if any, is not expected to have a material adverse impact on the Company's combined financial results.

#### Quantitative and Qualitative Disclosures About Market Risk

##### *Interest Rate Risk*

The Company is exposed to interest rate risk on future debt issuances. The Company manages its interest rate risk by limiting its exposure to variable interest rates primarily through the issuance of fixed-rate long-term debt. As a result of the fixed interest rates, the Company's fixed-rate long-term debt does not expose the Company to the risk of loss due to changes in market interest rates. Additionally, because fixed-rate long-term debt is not carried at fair value on the Combined Balance Sheets, changes in fair value would impact earnings and cash flows only if the Company were to reacquire all or a portion of these instruments prior to their maturity.

### *Price and Credit Risks*

The Company's primary source of electricity revenue is derived from payments received pursuant to long-term power sales agreements with Edison. Because of the Company's dependence on Edison, if Edison fails to fulfill its obligations to the Company, it could significantly impair the ability of the Company to fund operating and maintenance expenses, payments of interest and principal on the debt securities, projected capital expenditures and debt service reserve fund requirements. Approximately 87% of the Company's sales of electricity were to Edison in 2012.

In June and November 2001, the Salton Sea II, Salton Sea III, Vulcan, Elmore, Leathers and Del Ranch Projects and 16/36 of the Salton Sea IV Project (representing 72% of the Imperial Valley Projects' total net owned capacity), which were then receiving Edison's avoided cost of energy, entered into agreements that provided for amended energy payments. The amendments provided for fixed energy payments per kWh in lieu of Edison's avoided cost of energy. The fixed energy price was 3.25 cents per kWh from December 1, 2001, to April 30, 2002, and increased to 5.37 cents per kWh commencing May 1, 2002, through April 30, 2007. On May 30, 2006, the Imperial Valley Projects that received Edison's avoided cost of energy entered into amendments to their respective power purchase agreements with Edison which provided for a fixed energy price commencing May 1, 2007 and ending April 30, 2012. The amendments were approved by the California Public Utilities Commission and such approval became final on October 19, 2006. The energy price under the respective amended power purchase agreements during the fixed price period was 6.15 cents per kWh, escalated 1% annually beginning May 1, 2008. Beginning May 1, 2012, the projects subject to these amendments reverted back to Edison's avoided cost of energy, which is currently highly correlated to the cost of natural gas and was 3.0 cents per kWh, 4.0 cents per kWh and 4.3 cents per kWh for the years ended December 31, 2012, 2011 and 2010, respectively. There can be no assurances that Edison's avoided cost of energy after May 1, 2012 will result in revenues equivalent to the previous fixed energy payments received. Estimates of Edison's future avoided cost of energy could vary substantially from year to year primarily based on the future cost of natural gas and may be impacted by regulatory proceedings which may change the definition of the avoided cost of energy and other commodity factors.

## CERTIFICATION

I, Stephen A. Larsen, certify that:

1. I have reviewed this Annual Report of Salton Sea Funding Corporation and the Guarantors (collectively, the “Company”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures for Salton Sea Funding Corporation and the Guarantors and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the Company’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the Company’s internal control over financial reporting that occurred during the Company’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting; and
5. The Company’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company’s auditors and the audit committee of Company’s board of directors (or persons performing the equivalent function):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company’s internal control over financial reporting.

Date: March 26, 2013

/s/ Stephen A. Larsen  
Stephen A. Larsen  
President  
(principal executive officer)

## CERTIFICATION

I, Stephen D. Dickas, certify that:

1. I have reviewed this Annual Report of Salton Sea Funding Corporation and the Guarantors (collectively, the “Company”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures for Salton Sea Funding Corporation and the Guarantors and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the Company’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the Company’s internal control over financial reporting that occurred during the Company’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting; and
5. The Company’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company’s auditors and the audit committee of Company’s board of directors (or persons performing the equivalent function):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company’s internal control over financial reporting.

Date: March 26, 2013

/s/ Stephen D. Dickas  
Stephen D. Dickas  
Vice President & Controller  
(principal financial officer)



**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING BALANCE SHEET**  
**AS OF DECEMBER 31, 2012**

EXHIBIT A

(in thousands)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ -	\$ 2	\$ -	\$ 7,231	\$ 7,233
Trade receivables	11,256	7,661	-	-	18,917
Inventories	-	24,169	-	-	24,169
Other current assets	401	454	-	33	888
Total current assets	<u>11,657</u>	<u>32,286</u>	<u>-</u>	<u>7,264</u>	<u>51,207</u>
Property, plant and equipment, net	266,934	221,931	-	-	488,865
Goodwill	-	56,528	30,464	-	86,992
Intangible assets, net	13,520	21,379	4,813	-	39,712
Other assets	203	149	-	-	352
<b>Total assets</b>	<u>\$ 292,314</u>	<u>\$ 332,273</u>	<u>\$ 35,277</u>	<u>\$ 7,264</u>	<u>\$ 667,128</u>
<b>LIABILITIES AND OWNERS' EQUITY</b>					
Current liabilities:					
Accounts payable	\$ 2,545	\$ 8,262	\$ -	\$ -	\$ 10,807
Major maintenance accruals	118	2,534	-	-	2,652
Accrued interest	363	267	-	-	630
Current portion of secured project notes	8,452	6,212	-	(14,664)	-
Current portion of senior secured notes and bonds	-	-	-	14,664	14,664
Deferred income taxes	794	277	-	-	1,071
Other current liabilities	1,893	2,778	1	-	4,672
Total current liabilities	<u>14,165</u>	<u>20,330</u>	<u>1</u>	<u>-</u>	<u>34,496</u>
Secured project notes	49,838	36,628	-	(86,466)	-
Senior secured notes and bonds	-	-	-	86,466	86,466
Due to affiliates	1,122	66	-	-	1,188
Deferred income taxes	60,748	51,576	1,949	-	114,273
Total liabilities	<u>125,873</u>	<u>108,600</u>	<u>1,950</u>	<u>-</u>	<u>236,423</u>
Owners' equity:					
Owners' equity	166,441	223,649	33,327	7,264	430,681
Accumulated other comprehensive income, net	-	24	-	-	24
Total owners' equity	<u>166,441</u>	<u>223,673</u>	<u>33,327</u>	<u>7,264</u>	<u>430,705</u>
<b>Total liabilities and owners' equity</b>	<u>\$ 292,314</u>	<u>\$ 332,273</u>	<u>\$ 35,277</u>	<u>\$ 7,264</u>	<u>\$ 667,128</u>

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING BALANCE SHEET**  
**AS OF DECEMBER 31, 2011**  
(in thousands)

EXHIBIT A (Continued)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ -	\$ 5	\$ -	\$ 3,096	\$ 3,101
Trade receivables	14,577	16,633	-	-	31,210
Inventories	-	27,173	-	-	27,173
Other current assets	539	493	-	32	1,064
Total current assets	<u>15,116</u>	<u>44,304</u>	<u>-</u>	<u>3,128</u>	<u>62,548</u>
Property, plant and equipment, net	291,228	229,684	-	-	520,912
Goodwill	-	56,528	30,464	-	86,992
Intangible assets, net	14,670	24,936	5,635	-	45,241
Other assets	278	204	-	-	482
<b>Total assets</b>	<u>\$ 321,292</u>	<u>\$ 355,656</u>	<u>\$ 36,099</u>	<u>\$ 3,128</u>	<u>\$ 716,175</u>
<b>LIABILITIES AND OWNERS' EQUITY</b>					
Current liabilities:					
Accounts payable	\$ 167	\$ 913	\$ -	\$ -	\$ 1,080
Major maintenance accruals	212	70	-	-	282
Accrued interest	423	311	-	-	734
Current portion of secured project notes	9,576	7,038	-	(16,614)	-
Current portion of senior secured notes and bonds	-	-	-	16,614	16,614
Deferred income taxes	914	518	-	-	1,432
Other current liabilities	1,078	4,716	-	-	5,794
Total current liabilities	<u>12,370</u>	<u>13,566</u>	<u>-</u>	<u>-</u>	<u>25,936</u>
Secured project notes	58,290	42,840	-	(101,130)	-
Senior secured notes and bonds	-	-	-	101,130	101,130
Due to affiliates	1,096	569	-	-	1,665
Deferred income taxes	68,167	66,886	2,274	-	137,327
Total liabilities	<u>139,923</u>	<u>123,861</u>	<u>2,274</u>	<u>-</u>	<u>266,058</u>
Owners' equity:					
Owners' equity	181,369	232,679	33,825	3,128	451,001
Accumulated other comprehensive loss, net	-	(884)	-	-	(884)
Total owners' equity	<u>181,369</u>	<u>231,795</u>	<u>33,825</u>	<u>3,128</u>	<u>450,117</u>
<b>Total liabilities and owners' equity</b>	<u>\$ 321,292</u>	<u>\$ 355,656</u>	<u>\$ 36,099</u>	<u>\$ 3,128</u>	<u>\$ 716,175</u>

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING STATEMENT OF OPERATIONS**  
**FOR THE YEAR ENDED DECEMBER 31, 2012**  
(in thousands)

EXHIBIT A (Continued)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>Operating revenue</b>	\$ 85,924	\$ 81,333	\$ 8,901	\$ (8,901)	\$ 167,257
<b>Operating costs and expenses:</b>					
Royalty, operating, general and administrative expense	58,707	80,007	2,314	(8,844)	132,184
Depreciation and amortization	30,714	31,198	823	-	62,735
Total operating costs and expenses	<u>89,421</u>	<u>111,205</u>	<u>3,137</u>	<u>(8,844)</u>	<u>194,919</u>
<b>Operating (loss) income</b>	<u>(3,497)</u>	<u>(29,872)</u>	<u>5,764</u>	<u>(57)</u>	<u>(27,662)</u>
<b>Other income (expense):</b>					
Interest expense	(4,909)	(3,609)	-	-	(8,518)
Interest and other income	-	120	-	-	120
Total other income (expense)	<u>(4,909)</u>	<u>(3,489)</u>	<u>-</u>	<u>-</u>	<u>(8,398)</u>
<b>(Loss) income before income tax (benefit) expense</b>	(8,406)	(33,361)	5,764	(57)	(36,060)
Income tax (benefit) expense	(4,530)	(16,133)	1,786	(23)	(18,900)
<b>Net (loss) income</b>	<u>\$ (3,876)</u>	<u>\$ (17,228)</u>	<u>\$ 3,978</u>	<u>\$ (34)</u>	<u>\$ (17,160)</u>



**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING STATEMENT OF OPERATIONS**  
**FOR THE YEAR ENDED DECEMBER 31, 2011**  
(in thousands)

EXHIBIT A (Continued)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>Operating revenue</b>	\$ 109,656	\$ 116,479	\$ 14,981	\$ (14,981)	\$ 226,135
<b>Operating costs and expenses:</b>					
Royalty, operating, general and administrative expense	62,121	67,156	3,833	(14,922)	118,188
Depreciation and amortization	30,907	30,782	823	-	62,512
Total operating costs and expenses	<u>93,028</u>	<u>97,938</u>	<u>4,656</u>	<u>(14,922)</u>	<u>180,700</u>
<b>Operating income (loss)</b>	<u>16,628</u>	<u>18,541</u>	<u>10,325</u>	<u>(59)</u>	<u>45,435</u>
<b>Other income (expense):</b>					
Interest expense	(5,406)	(4,390)	-	-	(9,796)
Interest and other income	-	184	-	1	185
Total other income (expense)	<u>(5,406)</u>	<u>(4,206)</u>	<u>-</u>	<u>1</u>	<u>(9,611)</u>
<b>Income (loss) before income tax (benefit) expense</b>	11,222	14,335	10,325	(58)	\$ 35,824
Income tax (benefit) expense	<u>(5,574)</u>	<u>344</u>	<u>3,254</u>	<u>(85)</u>	<u>(2,061)</u>
<b>Net income</b>	<u>\$ 16,796</u>	<u>\$ 13,991</u>	<u>\$ 7,071</u>	<u>\$ 27</u>	<u>\$ 37,885</u>

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING STATEMENT OF OPERATIONS**  
**FOR THE YEAR ENDED DECEMBER 31, 2010**  
(in thousands)

EXHIBIT A (Continued)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>Operating revenue</b>	\$ 110,731	\$ 113,840	\$ 14,690	\$ (14,690)	\$ 224,571
<b>Operating costs and expenses:</b>					
Royalty, operating, general and administrative expense	55,625	66,681	4,002	(14,668)	111,640
Depreciation and amortization	29,428	30,647	823	-	60,898
Total operating costs and expenses	<u>85,053</u>	<u>97,328</u>	<u>4,825</u>	<u>(14,668)</u>	<u>172,538</u>
<b>Operating income (loss)</b>	<u>25,678</u>	<u>16,512</u>	<u>9,865</u>	<u>(22)</u>	<u>52,033</u>
<b>Other income (expense):</b>					
Interest expense	(5,985)	(5,912)	-	-	(11,897)
Interest and other income	-	406	-	7	413
Total other income (expense)	<u>(5,985)</u>	<u>(5,506)</u>	<u>-</u>	<u>7</u>	<u>(11,484)</u>
<b>Income (loss) before income tax expense</b>	19,693	11,006	9,865	(15)	\$ 40,549
Income tax expense	74,532	170	6,030	15	80,747
<b>Net (loss) income</b>	<u>\$ (54,839)</u>	<u>\$ 10,836</u>	<u>\$ 3,835</u>	<u>\$ (30)</u>	<u>\$ (40,198)</u>

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2012**

EXHIBIT A (Continued)

(in thousands)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>Cash flows from operating activities:</b>					
Net (loss) income	\$ (3,876)	\$ (17,228)	\$ 3,978	\$ (34)	\$ (17,160)
Adjustments to reconcile net (loss) income to net cash flows from operating activities:					
Depreciation and amortization	30,714	31,198	823	-	62,735
Deferred income taxes	(7,539)	(16,175)	(325)	-	(24,039)
Amortization of deferred financing costs	75	55	-	-	130
Changes in other operating assets and liabilities:					
Trade receivables	3,321	8,972	-	-	12,293
Inventories	-	3,004	-	-	3,004
Due to affiliates, net	(11,143)	9,380	(4,476)	11,170	4,931
Other assets	138	39	-	(1)	176
Accounts payable and other liabilities	3,046	7,942	-	-	10,988
Net cash flows from operating activities	<u>14,736</u>	<u>27,187</u>	<u>-</u>	<u>11,135</u>	<u>53,058</u>
<b>Cash flows from investing activities:</b>					
Capital expenditures	<u>(5,160)</u>	<u>(20,152)</u>	<u>-</u>	<u>-</u>	<u>(25,312)</u>
Net cash flows from investing activities	<u>(5,160)</u>	<u>(20,152)</u>	<u>-</u>	<u>-</u>	<u>(25,312)</u>
<b>Cash flows from financing activities:</b>					
Repayment of senior secured notes and bonds	(9,576)	(7,038)	-	-	(16,614)
Distributions	-	-	-	(7,000)	(7,000)
Net cash flows from financing activities	<u>(9,576)</u>	<u>(7,038)</u>	<u>-</u>	<u>(7,000)</u>	<u>(23,614)</u>
<b>Net change in cash and cash equivalents</b>	-	(3)	-	4,135	4,132
<b>Cash and cash equivalents at beginning of period</b>	-	5	-	3,096	3,101
<b>Cash and cash equivalents at end of period</b>	<u>\$ -</u>	<u>\$ 2</u>	<u>\$ -</u>	<u>\$ 7,231</u>	<u>\$ 7,233</u>

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2011**

EXHIBIT A (Continued)

(in thousands)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>Cash flows from operating activities:</b>					
Net income	\$ 16,796	\$ 13,991	\$ 7,071	\$ 27	\$ 37,885
Adjustments to reconcile net income to net cash flows from operating activities:					
Depreciation and amortization	30,907	30,782	823	-	62,512
Deferred income taxes	(11,672)	(484)	(315)	4	(12,467)
Amortization of deferred financing costs	84	87	-	-	171
Changes in other operating assets and liabilities:					
Trade receivables	677	(583)	-	-	94
Inventories	-	(3,073)	-	-	(3,073)
Due to affiliates, net	(17,669)	(4,929)	(7,579)	48,014	17,837
Other assets	62	65	-	3	130
Accounts payable and other liabilities	366	(678)	-	(66)	(378)
Net cash flows from operating activities	<u>19,551</u>	<u>35,178</u>	<u>-</u>	<u>47,982</u>	<u>102,711</u>
<b>Cash flows from investing activities:</b>					
Capital expenditures	<u>(14,555)</u>	<u>(20,182)</u>	<u>-</u>	<u>-</u>	<u>(34,737)</u>
Net cash flows from investing activities	<u>(14,555)</u>	<u>(20,182)</u>	<u>-</u>	<u>-</u>	<u>(34,737)</u>
<b>Cash flows from financing activities:</b>					
Repayment of senior secured notes and bonds	(4,996)	(14,994)	-	-	(19,990)
Distributions	-	-	-	(50,897)	(50,897)
Net cash flows from financing activities	<u>(4,996)</u>	<u>(14,994)</u>	<u>-</u>	<u>(50,897)</u>	<u>(70,887)</u>
<b>Net change in cash and cash equivalents</b>	-	2	-	(2,915)	(2,913)
<b>Cash and cash equivalents at beginning of period</b>	-	3	-	6,011	6,014
<b>Cash and cash equivalents at end of period</b>	<u>\$ -</u>	<u>\$ 5</u>	<u>\$ -</u>	<u>\$ 3,096</u>	<u>\$ 3,101</u>

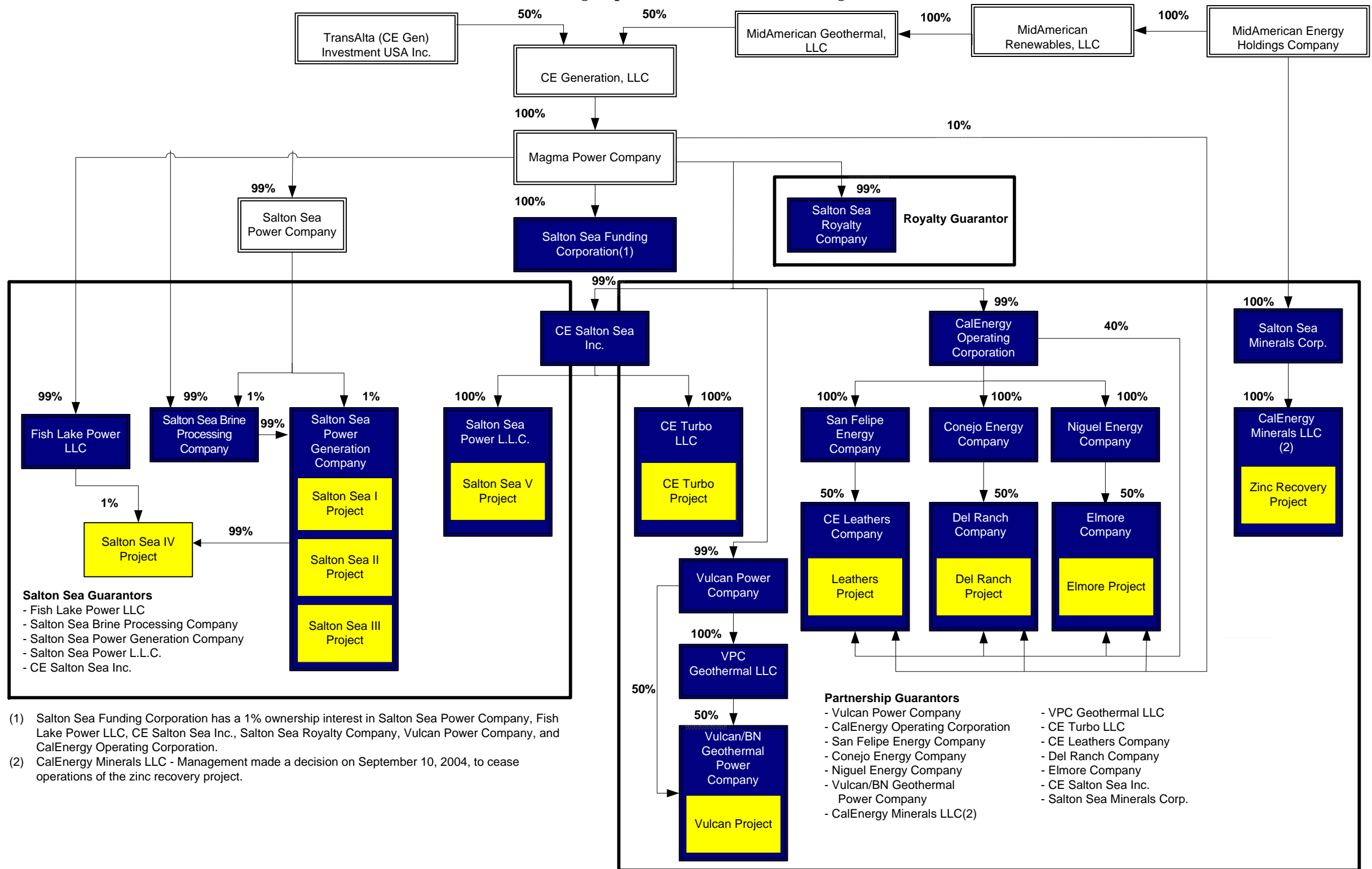
**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2010**

EXHIBIT A (Continued)

(in thousands)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>Cash flows from operating activities:</b>					
Net (loss) income	\$ (54,839)	\$ 10,836	\$ 3,835	\$ (30)	\$ (40,198)
Adjustments to reconcile net (loss) income to net cash flows from operating activities:					
Depreciation and amortization	29,428	30,647	823	-	60,898
Deferred income taxes	65,703	3,091	2,589	(4)	71,379
Amortization of deferred financing costs	121	146	-	-	267
Changes in other operating assets and liabilities:					
Trade receivables	(643)	(258)	-	-	(901)
Inventories	-	(276)	-	-	(276)
Due to affiliates, net	(12,080)	(3,314)	(7,246)	41,047	18,407
Other assets	44	159	-	24	227
Accounts payable and other liabilities	(507)	(3,990)	(1)	(572)	(5,070)
Net cash flows from operating activities	<u>27,227</u>	<u>37,041</u>	<u>-</u>	<u>40,465</u>	<u>104,733</u>
<b>Cash flows from investing activities:</b>					
Capital expenditures	(15,515)	(22,086)	-	-	(37,601)
Decrease in restricted cash	-	75	-	-	75
Net cash flows from investing activities	<u>(15,515)</u>	<u>(22,011)</u>	<u>-</u>	<u>-</u>	<u>(37,526)</u>
<b>Cash flows from financing activities:</b>					
Repayment of senior secured notes and bonds	(11,712)	(15,029)	-	-	(26,741)
Distributions	-	-	-	(48,850)	(48,850)
Net cash flows from financing activities	<u>(11,712)</u>	<u>(15,029)</u>	<u>-</u>	<u>(48,850)</u>	<u>(75,591)</u>
<b>Net change in cash and cash equivalents</b>	-	1	-	(8,385)	(8,384)
<b>Cash and cash equivalents at beginning of period</b>	-	2	-	14,396	14,398
<b>Cash and cash equivalents at end of period</b>	<u>\$ -</u>	<u>\$ 3</u>	<u>\$ -</u>	<u>\$ 6,011</u>	<u>\$ 6,014</u>

**Exhibit B - Salton Sea Funding Corporation and Guarantors - Organization Chart**



(1) Salton Sea Funding Corporation has a 1% ownership interest in Salton Sea Power Company, Fish Lake Power LLC, CE Salton Sea Inc., Salton Sea Royalty Company, Vulcan Power Company, and CalEnergy Operating Corporation.

(2) CalEnergy Minerals LLC - Management made a decision on September 10, 2004, to cease operations of the zinc recovery project.

- Salton Sea Guarantors**
- Fish Lake Power LLC
  - Salton Sea Brine Processing Company
  - Salton Sea Power Generation Company
  - Salton Sea Power L.L.C.
  - CE Salton Sea Inc.

- Partnership Guarantors**
- Vulcan Power Company
  - CalEnergy Operating Corporation
  - San Felipe Energy Company
  - Conejo Energy Company
  - Niguel Energy Company
  - Vulcan/BN Geothermal Power Company
  - CalEnergy Minerals LLC(2)
  - VPC Geothermal LLC
  - CE Turbo LLC
  - CE Leathers Company
  - Del Ranch Company
  - Elmore Company
  - CE Salton Sea Inc.
  - Salton Sea Minerals Corp.