



CE GENERATION_{LLC}

Consolidated Financial Statements

**As of December 31, 2006 and 2005 and for each of the
Three Years in the Period Ended December 31, 2006**

TABLE OF CONTENTS

Independent Auditors' Report	3
Consolidated Balance Sheets	4
Consolidated Statements of Operations and Comprehensive Income	5
Consolidated Statements of Members' Equity	6
Consolidated Statements of Cash Flows	7
Notes to Consolidated Financial Statements	8
Management's Discussion and Analysis of Financial Condition and Results of Operations	21

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Members
CE Generation, LLC
Omaha, Nebraska

We have audited the accompanying consolidated balance sheets of CE Generation, LLC and subsidiaries (the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of operations and comprehensive income, of members' equity, and of cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of CE Generation, LLC and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

Omaha, Nebraska
March 29, 2007

CE GENERATION, LLC AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In thousands)

	As of December 31,	
	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 44,447	\$ 38,836
Short-term investments	-	6,000
Restricted cash	7,282	7,203
Trade accounts receivable	53,766	59,338
Trade accounts receivable from affiliate	2,417	4,244
Income tax receivable	3,923	-
Inventories	29,624	28,515
Deferred income taxes	3,679	3,383
Prepaid expenses and other current assets	5,460	7,227
Total current assets	<u>150,598</u>	<u>154,746</u>
Restricted cash	2,426	2,212
Property, plant and equipment, net	824,748	877,012
Intangible assets, net	99,612	115,690
Goodwill	265,897	265,897
Deferred financing costs, net	4,895	5,925
Total assets	<u>\$ 1,348,176</u>	<u>\$ 1,421,482</u>
LIABILITIES AND MEMBERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 9,182	\$ 7,162
Accrued interest	2,611	2,736
Interest rate swap liability	590	2,252
Accrued natural gas liability	9,142	10,720
Other accrued liabilities	14,473	18,373
Income tax payable	-	2,699
Due to affiliates	4,971	726
Current portion of long-term debt	77,467	76,220
Total current liabilities	<u>118,436</u>	<u>120,888</u>
Parent senior secured bonds	271,800	289,800
Subsidiary and project debt	227,550	287,017
Deferred income taxes	248,723	253,268
Other long-term liabilities	10,940	10,002
Total liabilities	<u>877,449</u>	<u>960,975</u>
Minority interest	43,244	44,969
Commitments and contingencies (Note 10)		
Members' equity:		
Members' equity	429,405	416,566
Accumulated other comprehensive loss	(1,922)	(1,028)
Total members' equity	<u>427,483</u>	<u>415,538</u>
Total liabilities and members' equity	<u>\$ 1,348,176</u>	<u>\$ 1,421,482</u>

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

CE GENERATION, LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(In thousands)

	Year Ended December 31,		
	2006	2005	2004
Operating revenue	<u>\$ 476,603</u>	<u>\$ 483,956</u>	<u>\$ 439,866</u>
Costs and expenses:			
Fuel	103,817	108,635	92,065
Plant operations	135,619	120,010	133,939
General and administrative	3,569	3,350	3,983
Depreciation and amortization	96,447	87,973	90,855
Asset impairment (Note 3)	<u>-</u>	<u>-</u>	<u>54,537</u>
Total costs and expenses	<u>339,452</u>	<u>319,968</u>	<u>375,379</u>
Operating income	<u>137,151</u>	<u>163,988</u>	<u>64,487</u>
Other income (expense):			
Interest expense	(50,458)	(55,771)	(61,468)
Interest and other income	<u>6,684</u>	<u>4,931</u>	<u>4,362</u>
Total other income (expense)	<u>(43,774)</u>	<u>(50,840)</u>	<u>(57,106)</u>
Income before provision (benefit) for income taxes and minority interest	93,377	113,148	7,381
Provision (benefit) for income taxes	11,084	21,288	(11,570)
Minority interest	<u>28,454</u>	<u>27,234</u>	<u>22,035</u>
Net income (loss)	<u>53,839</u>	<u>64,626</u>	<u>(3,084)</u>
Other comprehensive income:			
Unrealized gain on cash flow hedges, net of tax of \$414, \$1,043 and \$1,857	<u>746</u>	<u>1,869</u>	<u>3,340</u>
Comprehensive income	<u>\$ 54,585</u>	<u>\$ 66,495</u>	<u>\$ 256</u>

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

CE GENERATION, LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY
FOR THE THREE YEARS ENDED DECEMBER 31, 2006
(In thousands)

	Members' Equity	Accumulated Other Comprehensive Loss	Total
Balance, January 1, 2004	\$ 425,122	\$ (6,237)	\$ 418,885
Distributions	(41,800)	-	(41,800)
Net loss	(3,084)	-	(3,084)
Other comprehensive income - Fair value adjustment on cash flow hedges, net of tax of \$1,857	-	3,340	3,340
Balance, December 31, 2004	380,238	(2,897)	377,341
Distributions	(28,298)	-	(28,298)
Net income	64,626	-	64,626
Other comprehensive income - Fair value adjustment on cash flow hedges, net of tax of \$1,043	-	1,869	1,869
Balance, December 31, 2005	416,566	(1,028)	415,538
Distributions	(41,000)	-	(41,000)
Net income	53,839	-	53,839
Other comprehensive income - Fair value adjustment on cash flow hedges, net of tax of \$414	-	746	746
Adjustment for plan sponsor adoption of FASB Statement No. 158 net of tax of \$(1,027)	-	(1,640)	(1,640)
Balance, December 31, 2006	\$ 429,405	\$ (1,922)	\$ 427,483

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

CE GENERATION, LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2006	2005	2004
Cash flows from operating activities:			
Net income (loss)	\$ 53,839	\$ 64,626	\$ (3,084)
Adjustments to reconcile net income (loss) to net cash flows from operating activities:			
Depreciation and amortization	96,447	87,973	90,855
Provision for deferred income taxes	(4,228)	3,647	(10,924)
Distributions to minority interest in excess of income	(2,228)	(1,916)	(5,515)
Asset impairment	-	-	54,537
Amortization of deferred financing costs	1,030	1,199	1,248
Changes in other items:			
Trade accounts receivable	7,399	(12,497)	(87)
Inventories	631	(1,911)	(1,339)
Due from affiliates, net	1,578	1,891	488
Accounts payable and other accrued liabilities	(7,852)	(3,562)	4,695
Prepaid expenses and other current assets	(2,156)	(1,139)	186
Net cash flows from operating activities	<u>144,460</u>	<u>138,311</u>	<u>131,060</u>
Cash flows from investing activities:			
Capital expenditures	(27,336)	(30,792)	(26,654)
Proceeds from related party note receivable	-	-	136,383
Purchases of available-for-sale securities	(267,000)	(99,500)	(249,000)
Proceeds from sales of available-for-sale securities	273,000	98,500	247,850
(Increase) decrease in restricted cash	(293)	(431)	4,732
Net cash flows from investing activities	<u>(21,629)</u>	<u>(32,223)</u>	<u>113,311</u>
Cash flows from financing activities:			
Repayment of subsidiary and project debt	(57,020)	(54,813)	(187,315)
Repayment of parent senior secured bonds	(19,200)	(14,800)	(14,600)
Cash distributions	(41,000)	(28,298)	(41,800)
Net cash flows from financing activities	<u>(117,220)</u>	<u>(97,911)</u>	<u>(243,715)</u>
Net change in cash and cash equivalents	5,611	8,177	656
Cash and cash equivalents at beginning of year	<u>38,836</u>	<u>30,659</u>	<u>30,003</u>
Cash and cash equivalents at end of year	<u>\$ 44,447</u>	<u>\$ 38,836</u>	<u>\$ 30,659</u>
Supplemental disclosure:			
Interest paid	<u>\$ 49,553</u>	<u>\$ 54,751</u>	<u>\$ 58,898</u>
Income taxes paid (refunded)	<u>\$ 19,619</u>	<u>\$ 19,418</u>	<u>\$ (1,356)</u>

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

CE GENERATION, LLC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Operations

CE Generation, LLC (“CE Generation”) is engaged in the independent power business and through its subsidiaries (together with CE Generation, the “Company”) owns and operates ten geothermal facilities in the Imperial Valley of California (the “Imperial Valley Projects”) and three natural gas-fired combined cycle cogeneration facilities located in New York, Arizona and Texas.

The following table sets out information concerning CE Generation's projects:

<u>Operating Project</u>	<u>Facility Net Capacity (MW)⁽¹⁾</u>	<u>Net MW Owned⁽¹⁾</u>	<u>Location</u>	<u>Power Purchase Agreement Expiration</u>	<u>Power Purchaser⁽²⁾</u>
<u>Geothermal Facilities:</u>					
Salton Sea Projects -					
Salton Sea I Project	10	10	California	2017	Edison
Salton Sea II Project	20	20	California	2020	Edison
Salton Sea III Project	50	50	California	2019	Edison
Salton Sea IV Project	40	40	California	2026	Edison
Salton Sea V Project	<u>49</u>	<u>49</u>	California	Varies ⁽³⁾	Various ⁽³⁾
Total Salton Sea Projects	<u>169</u>	<u>169</u>			
Partnership Projects -					
Vulcan Project	34	34	California	2016	Edison
Elmore Project	38	38	California	2018	Edison
Leathers Project	38	38	California	2019	Edison
Del Ranch Project	38	38	California	2019	Edison
CE Turbo Project	<u>10</u>	<u>10</u>	California	2029	APS
Total Partnership Projects	<u>158</u>	<u>158</u>			
Total geothermal facilities	<u>327</u>	<u>327</u>			
<u>Natural Gas-Fired Facilities:</u>					
Saranac Project	240	180	New York	2009	NYSE&G
Power Resources Project	212	212	Texas	2009	Constellation ⁽⁴⁾
Yuma Project	<u>50</u>	<u>50</u>	Arizona	2024	SDG&E
Total natural gas-fired facilities	<u>502</u>	<u>442</u>			
Total operating projects	<u>829</u>	<u>769</u>			

- (1) Represents the nominal net megawatt (“MW”) generating capability. Actual MW may vary depending on operating and reservoir conditions and plant design. Net MW Owned indicates current legal ownership, but, in the case of the Saranac Project, does not reflect the current allocation of partnership distributions.
- (2) Southern California Edison Company (“Edison”); Arizona Public Service (“APS”); New York State Electric & Gas Corporation (“NYSE&G”); Constellation Energy Commodities Group, Inc. (“Constellation”); and San Diego Gas & Electric Company (“SDG&E”).
- (3) The Salton Sea V Project provides 20 MW to Riverside Public Utilities (“Riverside”) and up to 26 MW to TransAlta USA Inc. (“TransAlta”), a wholly-owned subsidiary of TransAlta Corporation. Riverside has agreed to purchase 46 MW from the Salton Sea V Project beginning June 1, 2009.
- (4) Power Resources, Ltd. (“Power Resources”) entered into a tolling agreement with Constellation on January 11, 2007.

Prior to March 3, 1999, CE Generation was wholly-owned by MidAmerican Energy Holdings Company (“MEHC”). On March 3, 1999, MEHC sold 50% of its ownership interests in CE Generation to El Paso CE Generation Holding Company (“El Paso”). On January 29, 2003, TransAlta purchased El Paso’s 50% interest in CE Generation. As of May 31, 2005, TransAlta transferred all its rights and interests in CE Generation to TransAlta (CE GEN) Investments USA, Inc., which is also a wholly-owned subsidiary of TransAlta Corporation.

2. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of CE Generation, its wholly-owned subsidiaries and a majority-owned limited partnership, Saranac Power Partners L.P. (the “Saranac Partnership” or the “Saranac Project”), in which the Company indirectly holds a 1% general partnership and 74% limited partnership ownership interest. The remaining interests in the Saranac Partnership are owned by three limited partners. Net income and distributions from the Saranac Partnership are allocated to the partners based on allocation percentages that vary through the life of the partnership, as specified in the partnership agreement. These allocation percentages will differ from the stated ownership percentages until certain limited partners achieve fixed rates of returns. As of December 31, 2006, the Company’s economic interest in the partnership was approximately 70%, while the minority interest holders had a combined economic interest in the partnership of approximately 30%. The equity interest of the other partners is recorded as a minority interest in the accompanying consolidated financial statements.

Inter-company accounts and transactions have been eliminated.

Reclassifications

Certain amounts in the fiscal 2005 Consolidated Balance Sheet and supporting note disclosures have been reclassified to conform to the fiscal 2006 presentation. Such reclassifications did not impact previously reported net income, members’ equity or cash flows.

Use of Estimates in Preparation of Financial Statements

The preparation of the Consolidated 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 revenues and expenses during the period. These estimates include, but are not limited to, long-lived asset recovery, goodwill impairment and the accounting for contingencies, including environmental and income tax matters. Actual results may differ from the estimates used in preparing the Consolidated Financial Statements.

Cash Equivalents

Cash equivalents consist of funds invested in commercial paper, money market securities and in other investments with a maturity of three months or less when purchased. Cash and cash equivalents exclude amounts where the availability for distribution is restricted by legal requirements, loan agreements or other contractual provisions. The current restricted cash balance consists of debt service funds that require the maintenance of specific minimum balances equal to the next respective debt service payment. The non-current restricted cash balance consists of funds restricted for capital and major maintenance expenditures.

Short-term Investments

As of December 31, 2006 and 2005, the Company had \$- million and \$6.0 million, respectively, of short-term investments consisting of auction rate securities. These instruments are classified as available-for-sale securities as management does not intend to hold them to maturity nor are they bought and sold with the objective of generating profits on short-term differences in price.

Inventories

Inventories consist of spare parts and supplies and are valued at the lower of cost or market. Cost for large replacement parts is determined using the specific identification method. For the remaining supplies, cost is determined using the weighted average cost method.

Property, Plant and Equipment, Net

Property, plant and equipment is recorded at historical cost. The cost of major additions and betterments are capitalized, while costs for replacements, maintenance, overhaul and well rework and repairs that do not improve or extend the lives of the respective assets are charged to plant operations. Depreciation is generally computed by applying the straight-line method based on estimated economic lives. Effective October 1, 2006, the Saranac Project switched from a straight line methodology to a units of production methodology in calculating depreciation expense. This change resulted in an additional \$5.4 million of depreciation expense, of which \$1.4 million was attributable to minority owners and was allocated according to their respective ownership percentages. This prospective accounting change was treated as a change in estimate and was made to enable a consistent matching of expected future revenues and expenses. The Company believes the useful lives assigned to the depreciable assets, which range from 2 to 30 years, are reasonable.

The Company recognizes legal asset retirement obligations (“ARO”) mainly related to the obligations associated with the retirement of a landfill containing non hazardous geothermal waste and natural gas fired plant assets which reside on leased land. The fair value of a liability for a legal ARO is recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. The fair value of the liability 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 liability is adjusted for any material revisions to the expected value of the retirement obligation (with corresponding adjustments to property, plant, and equipment) and for accretion of the liability due to the passage of time.

Intangible Assets, Net

The Company’s intangible assets consist of acquired power purchase and royalty contracts and patented technology. These items are amortized by applying the straight-line method over the remaining contract periods, which range from 4 to 30 years.

Impairment of Long-Lived Assets

The Company evaluates long-lived assets, including property, plant and equipment and intangible assets, for impairment when events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. 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 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 discounted present value of the expected future cash flows from using the asset. Any resulting impairment loss is reflected in the Consolidated Statement of Operations.

Goodwill

Goodwill represents the difference between purchase price and the fair value of net assets acquired in business acquisitions. Goodwill is allocated to each reporting unit and is tested for impairment using a discounted projected future net cash flow methodology, at least annually and impairments, if any, are reflected in the Consolidated Statement of Operations. The Company completed its annual review as of October 31. Key assumptions used in the testing include, but are not limited to, the use of an appropriate discount rate and estimated future cash flows. In estimating cash flows, the Company incorporates current market information as well as historical factors. During 2006 and 2005, the Company did not record any goodwill impairments.

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 or at prevailing market rates. The majority of the contracts contain both fixed, or scheduled, and variable price periods. During the fixed or 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 billed.

CE Generation’s sales of electricity from the Imperial Valley Projects comprised approximately 44%, 46%, and 47%, of 2006, 2005, and 2004 operating revenue, respectively. Of these sales, approximately 87%, 86% and 87% were to Edison in 2006, 2005

and 2004, respectively. Sales of electricity from the Saranac Project comprised approximately 46%, 44% and 44%, of 2006, 2005 and 2004 operating revenue, respectively. Of these sales, all were to NYSE&G.

The trade accounts receivable balances are primarily uncollateralized receivables from long-term power purchase contracts. At December 31, 2006 and 2005, the trade accounts receivable balance from Edison was \$26.6 million and \$27.0 million, respectively, and from NYSE&G was \$18.9 million and \$18.4 million, respectively. The allowance for doubtful accounts is based on the Company's assessment of the collectibility of specific customer accounts and the aging of its accounts receivable. Additionally, an allowance is established when disputes under power purchase agreements arise. The outcomes of these disputes are subject to significant uncertainty. The Company recognizes an estimated loss if it is probable that the disputed amounts billed will not be collected and the loss can be reasonably estimated. The Company uses judgment and evaluates, with the assistance of legal counsel, whether a loss should be disclosed or recognized as an adjustment to operating revenue. Historically, excluding contract disputes, the Company's trade accounts receivable balances have been collectible and no significant bad debt expense has been recognized. However, if there is a deterioration of a significant customer's credit worthiness, estimates of recoverability of the trade accounts receivable balances could be adversely affected. At December 31, 2006 and 2005, there was no allowance for doubtful accounts recorded.

Income Taxes

CE Generation and its subsidiaries file a consolidated U.S. federal income tax return and other state and federal jurisdictional returns as required. Deferred tax assets and liabilities are based on differences between the financial statements and tax bases of assets and liabilities using the estimated tax rates 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 are charged or credited directly to other comprehensive income. Otherwise, changes in deferred income tax assets and liabilities are included as a component of income tax expense.

In determining the Company's tax liabilities, management is required to interpret complex tax laws and regulations. In preparing tax returns, the Company is subject to continuous examinations by federal, state and local 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 Internal Revenue Service has closed examination of the Company's income tax returns through 2003. Although the ultimate resolution of the Company's federal and state tax examinations is uncertain, the Company believes it has made adequate provisions for these tax positions and the aggregate amount of any additional tax liabilities that may result from these examinations, if any, will not have a material adverse affect on the Company's financial results. The Company's provision for tax uncertainties is included in income tax payable and other long-term liabilities, as appropriate, in the accompanying Consolidated Balance Sheets.

Risk Management and Hedging Activities

The Company utilizes swap agreements to manage interest rate risks and to reduce its exposure resulting from fluctuations in interest rates. Derivative instruments are recorded in the accompanying Consolidated Balance Sheets at fair value, as either assets or liabilities. The Company's practice is not to hold or issue derivative instruments for trading purposes.

The interest rate swap agreements are considered cash flow hedges and, therefore, changes in the fair value, to the extent effective, of these derivative instruments are included in the accompanying Consolidated Statements of Members' Equity and Comprehensive Income as accumulated other comprehensive income, net of tax, until the hedged item is recognized in earnings. These instruments are either exchange traded or with counterparties of high credit quality; therefore, the risk of nonperformance by the counterparties is considered to be negligible.

New Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115" ("SFAS No. 159"). SFAS No. 159 permits entities to elect to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS No. 159, an entity may elect the fair value option for eligible items that exist at the adoption date. Subsequent to the initial adoption, the election of the fair value option should only be made at initial recognition of the asset or liability or upon a remeasurement event that gives rise to new-basis accounting. The decision about whether to elect the fair value option is applied on an instrument-by-instrument basis, is irrevocable and is applied only to an entire instrument and not only to

specified risks, cash flows or portions of that instrument. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value nor does it eliminate disclosure requirements included in other accounting standards. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS No. 159 on its consolidated financial position and results of operations.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)" ("SFAS No. 158"). SFAS No. 158 requires an employer to recognize in its statement of financial position the over- or under-funded status of a defined benefit postretirement plan measured as the difference between the fair value of plan assets and the benefit obligation. For a pension plan, the benefit obligation is the projected benefit obligation; for any other postretirement benefit plan, such as a retiree health care plan, the benefit obligation is the accumulated postretirement benefit obligation. SFAS No. 158 also requires entities to recognize as a component of other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits that arise during the period, but were not recognized as components of net periodic benefit cost of the period pursuant to SFAS No. 87, "Employers' Accounting for Pensions" ("SFAS No. 87") and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" ("SFAS No. 106"). The Company participates in multi-employer benefit plans sponsored by MidAmerican Energy Company ("MEC"), an affiliate company and wholly-owned subsidiary of MEHC. The portion of accumulated other comprehensive income attributable to the Company has been allocated from MEC in accordance with intercompany service agreements. SFAS No. 158 does not impact the calculation of net periodic benefit cost allocated from MEC and the amounts recognized as accumulated other comprehensive income will be adjusted as they are subsequently recognized as components of net periodic benefit cost pursuant to the recognition and amortization provisions of SFAS No. 87 and SFAS No. 106.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 does not impose fair value measurements on items not already accounted for at fair value; rather it applies, with certain exceptions, to other accounting pronouncements that either require or permit fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact of adopting SFAS No. 157 on its consolidated financial position and results of operations.

In September 2006, the FASB issued FASB Staff Position ("FSP") No. AUG AIR-1, "Accounting for Planned Major Maintenance Activities." This FSP addresses appropriate methods of accounting for planned major maintenance activities and specifically prohibits the use of the accrue-in-advance method. The Company currently expenses costs as incurred for major maintenance activities, which is permitted under this FSP. This FSP is effective for fiscal years beginning after December 15, 2006. The Company does not believe this FSP will have any impact on the Company's consolidated financial position and results of operations.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, "Accounting for Income Taxes," and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a return. Guidance is also provided on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company is required to adopt FIN 48 in the first quarter of fiscal year 2007. The Company is currently evaluating the impact and based upon its assessment to date does not believe the adoption of FIN 48 will have a material effect on its consolidated financial position.

3. Property, Plant and Equipment, Net

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

	<u>Estimated Useful Lives</u>	<u>2006</u>	<u>2005</u>
Power plants	5 to 30 years	\$1,196,148	\$1,188,120
Wells and resource development	2 to 30 years	226,171	221,995
Equipment	3 to 30 years	<u>6,118</u>	<u>6,055</u>
Total operating assets		1,428,437	1,416,170
Accumulated depreciation		<u>(603,689)</u>	<u>(539,158)</u>
Property, plant and equipment, net		<u>\$ 824,748</u>	<u>\$ 877,012</u>

Asset Impairments

On August 5, 2003, Power Resources, an indirect wholly-owned subsidiary of the Company, entered into a tolling agreement with ONEOK Energy, Marketing and Trading Company, L.P. ("ONEOK"). The agreement commenced October 1, 2003 and expired December 31, 2005. Given the expiration of the tolling agreement with ONEOK and the surplus of generation capacity and energy prices in the Electric Reliability Council of Texas markets at the time, the Company evaluated Power Resources' long-lived assets to assess whether the carrying value of the assets was recoverable and, during the fourth quarter of 2004, management determined that a portion of the carrying value of the Power Resources' long-lived assets was no longer recoverable. As a result, the Company recognized a non-cash impairment charge of \$54.5 million, \$33.5 million, after-tax, to write down the long-lived assets to their fair value. The fair value was determined based on discounted estimated cash flows from the future use of the long-lived assets. The impairment charge did not result in any current or future cash expenditures. Power Resources entered into a tolling agreement with Constellation on January 11, 2007.

Additionally, the Company replaced certain pipe in 2006, 2005 and 2004 with a remaining net book value of \$4.7 million, \$4.3 million and \$6.7 million, respectively, which was charged to depreciation expense in the accompanying Consolidated Statements of Operations.

4. Intangible Assets, Net

Intangible assets comprise the following at December 31 (in thousands):

		<u>2006</u>		<u>2005</u>	
	<u>Estimated Useful Lives</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Power Purchase and Royalty					
Contracts	4 to 30 years	\$ 315,434	\$ 238,834	\$ 315,434	\$ 224,861
Patented Technology	24 years	<u>46,290</u>	<u>23,278</u>	<u>46,290</u>	<u>21,173</u>
Total		<u>\$ 361,724</u>	<u>\$ 262,112</u>	<u>\$ 361,724</u>	<u>\$ 246,034</u>

Amortization expense on acquired intangible assets was \$16.1 million, \$15.8 million and \$15.8 million for the years ended December 31, 2006, 2005 and 2004, respectively. CE Generation expects amortization expense on acquired intangible assets to be \$16.0 million for each of the two succeeding fiscal years, \$11.9 million in 2009, and \$5.7 million in 2010 and 2011.

5. Subsidiary and Project Debt

Each of CE Generation's direct or indirect subsidiaries is organized as a legal entity separate and apart from CE Generation and its other subsidiaries. Pursuant to separate project financing agreements applicable to the Imperial Valley Projects and the Saranac Project, the assets of each subsidiary with a direct or indirect ownership interest in the Imperial Valley Projects other than Magma Power Company and Salton Sea Power Company and each subsidiary with a direct ownership interest in the subsidiary that owns interests in the Saranac Project are pledged or encumbered to support or otherwise provide the security for their own project or subsidiary debt, therefore it should not be assumed that any of these assets will be available to satisfy the obligations of CE Generation or any of its other subsidiaries; provided, however, that unrestricted cash or other assets which are

available for distribution may, subject to applicable law and the terms of financing arrangements for such parties, be advanced, loaned, paid as dividends or otherwise distributed or contributed to CE Generation or affiliates thereof.

Subsidiary and project debt consists of the following at December 31 (in thousands):

	<u>2006</u>	<u>2005</u>
Salton Sea Bonds	\$ 243,841	\$ 269,757
Saranac Note Payable	<u>43,176</u>	<u>74,280</u>
Total Subsidiary and Project Debt	287,017	344,037
Less current portion	<u>(59,467)</u>	<u>(57,020)</u>
Total Long-Term Subsidiary and Project Debt	<u>\$ 227,550</u>	<u>\$ 287,017</u>

Salton Sea Bonds

Salton Sea Funding Corporation (“Funding Corporation”), a wholly-owned indirect subsidiary of CE Generation, has issued debt securities as follows (in thousands):

<u>Issued Date</u>	<u>Senior Secured Series</u>	<u>Final Maturity Date</u>	<u>Rate</u>	<u>December 31,</u>	
				<u>2006</u>	<u>2005</u>
July 21, 1995	C Bonds	May 30, 2010	7.84%	\$ 75,048	\$ 96,586
June 20, 1996	E Bonds	May 30, 2011	8.30%	34,072	36,572
October 13, 1998	F Bonds	November 30, 2018	7.48%	<u>134,721</u>	<u>136,599</u>
				<u>\$ 243,841</u>	<u>\$ 269,757</u>

Principal and interest payments are made in semi-annual installments. Funding Corporation debt is non-recourse to CE Generation.

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 Power Company, a wholly-owned subsidiary of the Company, 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 Power Company and used for 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.

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 \$23.1 million at December 31, 2006.

Annual repayments of Funding Corporation debt for the years ending December 31 are as follows (in thousands):

2007	\$ 25,091
2008	28,065
2009	26,210
2010	26,741
2011	19,990
Thereafter	<u>117,744</u>
Total	<u>\$ 243,841</u>

CE Generation's ability to obtain distributions from its investment in the Imperial Valley Projects is subject to the following conditions:

- the depository accounts for Funding Corporation debt must be fully funded;
- there cannot have occurred and be continuing any default or event of default under Funding Corporation debt;
- the historical debt service coverage ratio of Funding Corporation for the prior four fiscal quarters must be at least 1.5 to 1.0; and
- there must be sufficient geothermal resources to operate the Imperial Valley Projects at their required levels.

Saranac Note Payable

On October 7, 1994, the Saranac Partnership signed a 14-year note payable agreement with a lender for an initial principal amount of \$204.6 million. Under the terms of the note payable agreement, interest rate alternatives include an option to use a Eurodollar rate or the lender's base rate. Each option includes an interest margin in addition to the applicable rate selected. The selected interest rate, plus interest margin, at December 31, 2006 and 2005 was 6.74% and 5.40%, respectively.

Effective October 7, 1994, the Saranac Partnership entered into an interest rate swap agreement with the lender as a means of hedging floating interest rate exposure related to its 14-year note payable that effectively fixes the interest rate at 8.56%. The Saranac Partnership may be exposed to credit loss in the event of nonperformance by the lender under the interest rate swap agreement. However, the Saranac Partnership does not anticipate nonperformance by the lender. The fair value of the swap as of December 31, 2006 and 2005 was \$0.6 million and \$2.3 million, respectively.

Annual repayments of the note payable for the years ending December 31 are as follows (in thousands):

2007	\$ 34,376
2008	<u>8,800</u>
Total	<u>\$ 43,176</u>

The note agreements are collateralized by all of the Saranac Partnership's assets. The Saranac Partnership is restricted by the terms of the note payable agreement from making distributions or withdrawing any capital accounts without the consent of the lender. Under the terms of the note payable agreement, distributions may be made to the partners in accordance with the terms of the Saranac Partnership's limited partnership agreement. The note payable agreement also requires the Saranac Partnership to maintain certain covenants. The Saranac Partnership was in compliance with these requirements at December 31, 2006.

6. Parent Senior Secured Bonds

On March 2, 1999, CE Generation issued \$400.0 million of 7.416% senior secured bonds due 2018 (the "Senior Secured Bonds"). These securities are senior secured debt which rank equally in right of payment with CE Generation's other senior secured debt permitted under the indenture for the securities, share equally in the collateral with CE Generation's other senior secured debt permitted under the indenture for the securities, and rank senior to any of CE Generation's subordinated debt permitted under the indenture for the securities. These securities are effectively subordinated to the existing project financing debt and all other debt of CE Generation's consolidated subsidiaries. The outstanding balance as of December 31, 2006 and 2005 was \$289.8 million and \$309.0 million, respectively.

The Senior Secured Bonds are primarily secured by the following collateral:

- all available cash flow (as defined);
- a pledge of 99% of the equity interests in Salton Sea Power Company and all of CE Generation's equity interests in its other consolidated subsidiaries;
- a pledge of all of the capital stock of SECI Holding Inc., an indirect wholly-owned subsidiary of the Company;

- a grant of a lien on and security interest in the depository accounts; and
- to the extent possible, a grant of a lien on and security interest in all of CE Generation's other tangible and intangible property, to the extent assignable.

A financial institution had issued for the account of CE Generation a debt service reserve letter of credit in the amount of \$24.2 million in favor of the holders of the Senior Secured Bonds. On February 9, 2006, the previous \$24.2 million debt service reserve letter of credit was replaced by a letter of credit issued by a financial institution for the account of TransAlta and by a letter of credit issued by a separate financial institution for the account of MEHC. Each of the two letters of credit are currently issued in the amount of \$12.1 million.

Annual repayments of the Senior Secured Bonds for the years ending December 31 are as follows (in thousands):

2007	\$ 18,000
2008	28,200
2009	24,600
2010	14,200
2011	15,200
Thereafter	<u>189,600</u>
Total	<u>\$ 289,800</u>

7. Asset Retirement Obligations

The change in the balance of the total ARO liability, which is included in other long-term liabilities in the accompanying Consolidated Balance Sheets, for the years ended December 31 is summarized as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Balance, January 1	\$ 9,523	\$ 8,220
Revisions	-	1,040
Accretion	<u>657</u>	<u>263</u>
Balance, December 31	<u>\$10,180</u>	<u>\$ 9,523</u>

On December 31, 2005, the Company adopted Financial Accounting Standards Board (“FASB”) Interpretation No. 47, “Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143” (“FIN 47”). FIN 47 clarifies that the term *conditional asset retirement obligation* as used in Statement of Financial Accounting Standards (“SFAS”) No. 143, “Accounting for Asset Retirement Obligations” (“SFAS 143”). SFAS 143 refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. Accordingly, the Company is required to recognize a liability for the fair value of a conditional ARO if the fair value of the liability can be reasonably estimated. Uncertainty about the timing or method of settlement of a conditional ARO should be factored into the measurement of the liability when sufficient information exists.

In adopting both SFAS No. 143 and FIN 47, the Company’s review identified legal retirement obligations for power plant and well abandonment costs. The Company used an expected cash flow approach to measure the obligations. Due to the renewable nature of the geothermal resource, the power plants and wells could be maintained and remain in production indefinitely. Accordingly, because the date on which such ARO expenditures will be made is indeterminate, the fair value of the ARO cannot be reasonably estimated. Gas plants which reside on owned land have no legal retirement obligation.

8. Income Taxes

The provision (benefit) for income taxes consists of the following for the years ended December 31 (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Current:			
Federal	\$ 11,583	\$ 14,639	\$ (807)
State	<u>3,729</u>	<u>3,002</u>	<u>161</u>
	<u>15,312</u>	<u>17,641</u>	<u>(646)</u>
Deferred:			
Federal	(2,264)	3,812	(9,431)
State	<u>(1,964)</u>	<u>(165)</u>	<u>(1,493)</u>
	<u>(4,228)</u>	<u>3,647</u>	<u>(10,924)</u>
Total	<u>\$ 11,084</u>	<u>\$ 21,288</u>	<u>\$ (11,570)</u>

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

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Federal statutory rate	35.0%	35.0%	35.0%
Percentage depletion	(9.3)	(6.4)	(57.8)
Energy tax credits	(2.9)	(1.4)	(13.2)
Production activities deduction	(0.6)	(0.6)	-
State taxes, net of federal benefit	1.9	2.0	(11.7)
Minority interest	(10.7)	(8.4)	(104.5)
Other items, net	<u>(1.5)</u>	<u>(1.4)</u>	<u>(4.6)</u>
Effective tax rate	<u>11.9%</u>	<u>18.8%</u>	<u>(156.8)%</u>

Income tax expense is only provided for the taxable earnings of the Company, including its partnership interests. No provision for income taxes is provided in the accompanying Consolidated Financial Statements for the minority interests' share of the partnership earnings.

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

	<u>2006</u>	<u>2005</u>
Deferred tax assets:		
Accruals not currently deductible for tax purposes	\$ 3,411	\$ 4,357
Employee benefits	1,027	-
Credit carryforwards	<u>6,432</u>	<u>4,287</u>
Total deferred tax assets	<u>10,870</u>	<u>8,644</u>
Deferred tax liabilities:		
Property, plant, contracts and equipment, net	(250,759)	(253,506)
Other	<u>(5,155)</u>	<u>(5,023)</u>
Total deferred tax liabilities	<u>(255,914)</u>	<u>(258,529)</u>
Net deferred tax liability	<u>\$ (245,044)</u>	<u>\$ (249,885)</u>
Reflected as:		
Deferred income taxes - current asset	\$ 3,679	\$ 3,383
Deferred income taxes - non-current liability	<u>(248,723)</u>	<u>(253,268)</u>
	<u>\$ (245,044)</u>	<u>\$ (249,885)</u>

As of December 31, 2006, CE Generation has a federal energy tax credit carryforward of \$2.3 million that begins to expire in 2022 unless previously utilized. CE Generation has federal and state alternative minimum tax credit carryforwards of \$4.1 million that do not expire and will carryforward indefinitely until utilized.

9. Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, short-term investments, receivables, payables and accrued liabilities approximates fair value because of the short-term maturity or frequent remarketing of these instruments. Derivative instruments are recorded at their fair values, which are based upon quoted market prices for debt issues actively traded or on market prices of similar instruments.

The fair value of the Company's long-term debt has been estimated based upon quoted market prices as supplied by third-party broker dealers. The carrying amount of variable-rate long-term debt approximates fair value because of the frequent repricing of these instruments at market rates. The following table presents the carrying amount and estimated fair value of the Company's long-term debt, including the current portion, as of December 31 (in thousands):

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt	<u>\$ 576,817</u>	<u>\$ 596,814</u>	<u>\$ 653,037</u>	<u>\$ 695,267</u>

10. Commitments and Contingencies

The California Power Exchange

In January 2001, the California Power Exchange declared bankruptcy. As a result, Salton Sea Power, LLC ("Salton Sea Power") and CE Turbo, LLC ("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 with TransAlta and MEHC (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 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. As of December 31, 2006, EPME had not made any payments in connection with the PX Receivable.

Environmental Matters

The Company is subject to federal, state, and local laws and regulations regarding air and water quality, hazardous and solid waste disposal and other environmental matters and believes it is in material compliance with current environmental requirements.

Air Quality

Litigation was filed in the federal district court for the southern district of New York seeking to require reductions of carbon dioxide emissions from generating facilities of five large electric utilities. The court dismissed the suit, ruling that critical issues affecting the United States, like greenhouse gas emissions reductions, are not the domain of the courts and should be resolved by the executive branch of the federal government and the U.S. Congress. This ruling has been appealed to the Second Circuit Court of Appeals. The outcome of climate change litigation and federal and state climate change initiatives cannot be determined at this time; however, adoption of stringent limits on greenhouse gas emissions could significantly impact the Company's natural gas-fired facilities and, therefore, its financial results.

The EPA's regulation of certain pollutants under the Clean Air Act, and its failure to regulate other pollutants, is being challenged by various lawsuits brought by both individual state attorney generals and environmental groups. To the extent that these actions may be successful in imposing additional and/or more stringent regulation of emissions on natural gas-fired facilities in general and the Company's facilities in particular, such actions could significantly impact the Company's natural gas-fired facilities and, therefore, its financial results.

Accrued Environmental Costs

The Company is fully or partly responsible for environmental remediation that results from other than normal operations 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 expense is 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, 2006 and 2005 was \$0.9 million and \$7.9 million, respectively, and is included in other accrued liabilities and other long-term accrued liabilities on the accompanying Consolidated Balance Sheets. Environmental remediation liabilities that result from the normal operation of a long-lived asset and that are associated with the retirement of those assets are accounted for as an asset retirement obligation.

On August 22, 2006, the California governor signed Senate Bill 1294 - Geothermal Waste Exemption ("SB 1294"). With the enactment of SB 1294, the Imperial Valley Projects' brine ponds are not subject to regulation by the California Department of Toxic Substances Control ("DTSC") as hazardous waste treatment, storage and disposal facilities. Accordingly, a \$3.6 million reduction in hazardous brine pond waste liability was recognized during the year ended December 31, 2006.

Other

The Saranac Partnership has a contract to purchase natural gas from a third party for its cogeneration facility for a period of 15 years for an amount up to 51,000 MMBtus per day which expires in 2009. The price for such deliveries is a stated rate, escalated annually at a rate of 4%. The minimum volumes under the agreement for the years ending December 31 are included in the future minimum payments under the contract as follows (in thousands):

2007	\$ 74,137
2008	77,313
2009	<u>37,536</u>
Total	<u>\$ 188,986</u>

11. Related Party Transactions

Pursuant to an administrative services agreement between CalEnergy Generation Operating Company ("CGOC"), a subsidiary of MEHC, and CE Generation (the "Administrative Services Agreement"), CGOC provides certain administrative and management services to CE Generation. The Administrative Services Agreement between CGOC and CE Generation provided for a fixed fee through December 31, 2007. The expense pursuant to the Administrative Services Agreement for 2006, 2005 and 2004 totaled \$3.0 million, \$3.0 million and \$3.1 million, respectively, and is included in general and administrative costs and expenses in the accompanying Consolidated Statements of Operations.

The Company participates in multi-employer pension plans sponsored by MEC, an indirect wholly-owned subsidiary of MEHC. The Company's contribution to the various plans was \$2.5 million, \$2.4 million and \$2.1 million in 2006, 2005 and 2004, respectively.

Pursuant to a transaction agreement dated January 29, 2003 (the "TransAlta Transaction Agreement"), Salton Sea Power and CE Turbo began selling available power from the Salton Sea V Project and CE Turbo Project to TransAlta on February 12, 2003, based on percentages of the Dow Jones SP-15 Index. The TransAlta Transaction Agreement shall continue until the earlier of (a) 30 days following a written notice of termination, or (b) any other termination date mutually agreed to by the parties. No such notice of termination has been given by either party. Pursuant to this agreement, sales to TransAlta totaled \$11.1 million, \$16.4 million and \$10.5 million in 2006, 2005 and 2004, respectively. As of December 31, 2006 and 2005, accounts receivable balances from TransAlta were \$2.2 million and \$4.1 million, respectively. Effective August 7, 2006 through May 31, 2009, up to 26 MW of available power from the Salton Sea V Project will be sold to TransAlta under the TransAlta Transaction Agreement at a fixed price. Each of Salton Sea Power, CE Turbo, and TransAlta have agreed not to exercise their respective 30 day termination right described above with respect to such amount of available power through such period.

On January 21, 2004, Salton Sea Power and CE Turbo entered into a Green Energy Tag Purchase and Sale Agreement to sell the non-power attributes (the non-power attributes made available by one megawatt hour ("MWh") of generation, a "Green

Tag”) associated with up to 931,800 MWh of available generation of the Salton Sea V Project and the CE Turbo Project through December 31, 2008 to TransAlta Energy Marketing (US) Inc. (“TransAlta Marketing”) at a market price per Green Tag. Pursuant to this agreement, sales to TransAlta Marketing commenced in July 2004 and totaled \$2.2 million, \$2.2 million, and \$0.5 million in 2006, 2005 and 2004, respectively. As of December 31, 2006 and 2005, accounts receivable balances from TransAlta Marketing were \$0.2 million and \$0.2 million, respectively.

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

The following is management's discussion and analysis of certain significant factors which have affected the financial condition and results of operations of CE Generation, LLC ("CE Generation") and its subsidiaries (together with CE Generation, the "Company") during the periods included in the accompanying Consolidated Financial Statements. This discussion should be read in conjunction with the Company's historical Consolidated Financial Statements and the related notes thereto. The Company's actual results in the future could differ significantly from the historical results.

Forward-Looking Statements

From time to time, CE Generation 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 recovery, cost reduction strategies and anticipated outcomes, pricing strategies, changes in the utility industry, planned capital expenditures, financing needs and availability, statements of CE Generation'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. CE Generation 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 does not assume any responsibility to update forward-looking information contained herein.

Executive Summary

The following significant events and changes occurred during 2006, as discussed in more detail herein, that highlight some of the factors which affected, or may affect in the future, the Company's financial condition, results of operations and liquidity:

- On May 30, 2006, the Imperial Valley Projects that receive Edison's avoided cost of energy entered into amendments to their respective power purchase agreements which provide for a fixed energy price commencing May 1, 2007, and ending April 30, 2012. The amendments were approved by the California Public Utilities Commission ("CPUC") and such approval became final on October 19, 2006. The energy price under the respective amended power purchase agreements during the fixed price period will be 6.15 cents per kilowatt-hour ("kWh"), escalated 1% annually beginning May 1, 2008. The current energy price of 5.37 cents per kWh will remain in effect through April 30, 2007.
- On August 2, 2006, Salton Sea Power and CE Turbo entered into a transaction under the TransAlta Transaction Agreement which provides for a fixed energy price commencing on August 7, 2006, and ending on May 31, 2009. The energy price under this transaction will be 6.05 cents per kWh.
- The Company's Yuma Cogeneration Associates Project (the "Yuma Project") and Power Resources Ltd. Project (the "Power Resources Project") underwent scheduled major maintenance from March through April 2006. These extensive maintenance events are scheduled approximately every six years.
- The Company's ten geothermal facilities in the Imperial Valley of California (the "Imperial Valley Projects") had more extensive brine system and turbine overhauls in 2006 compared to less extensive brine system and turbine overhauls in 2005. The more extensive overhauls are longer in duration and have higher associated repair and maintenance costs. The overhaul schedules vary from year to year and are scheduled at intervals based on plant operating hours.

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 Consolidated Financial Statements for the net capacity of each facility. Each plant possesses an operating margin, which allows for production in excess of a facilities 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.

CE Generation's operating revenue is summarized as follows (in thousands):

	Year Ended December 31		
	2006	2005	2004
Natural gas-fired facilities	\$ 267,915	\$ 262,378	\$ 232,996
Geothermal facilities	<u>208,688</u>	<u>221,578</u>	<u>206,870</u>
Total operating revenue	<u>\$ 476,603</u>	<u>\$ 483,956</u>	<u>\$ 439,866</u>

Natural Gas-Fired Facilities

The following operating data represents the aggregate capacity and electricity production at the natural gas-fired facilities:

	Year Ended December 31		
	2006	2005	2004
Overall capacity factor	68.1%	71.9%	62.9%
Megawatt hours ("MWh") produced	2,993,200	3,162,600	2,775,600
Capacity (net MW) (weighted average)	502.0	502.0	502.0

Operating revenue at the natural gas-fired facilities increased \$5.5 million, or 2.1%, in 2006 versus 2005 primarily due to the following:

- \$7.6 million increase due to rate escalations under the Saranac Project's 15-year power purchase agreement.
- \$3.8 million increase associated with the Power Resources Project's merchant plant operation.
- The Yuma Project sells energy to San Diego Gas & Electric Company at its avoided cost of energy, which decreased to 7.2 cents per kWh in 2006 from 8.8 cents per kWh in 2005, resulting in a \$5.5 million decrease in operating revenue. The Yuma Project also incurred decreased fuel costs.

The decreases in the overall capacity factor and MWh produced in 2006 versus 2005 were due to a decrease in dispatch at the Power Resources and Yuma Projects due to the aforementioned scheduled major maintenance activity in 2006.

Operating revenue at the natural gas-fired facilities increased \$29.4 million, or 12.6%, in 2005 versus 2004 primarily due to the following:

- \$12.8 million increase at the Saranac Project due to a 6.4% increase in production over 2004. Maintenance was completed on the Saranac Project's turbine during the fourth quarter of 2004 resulting in lower production during that period.
- The Yuma Project sells energy to San Diego Gas & Electric Company at its avoided cost of energy, which increased to 8.8 cents per kWh in 2005 from 6.6 cents per kWh in 2004, resulting in a \$7.4 million increase in revenue. The Yuma Project also incurred increased fuel costs.

- \$6.8 million increase due to rate escalations under the Saranac Project's 15-year power purchase agreement.

The increases in the overall capacity factor and MWh produced in 2005 versus 2004 were due to an increase in dispatch at the Power Resources Project under the tolling agreement with ONEOK and the 6.4% increase at the Saranac Project discussed above. The majority of the revenue under the tolling agreement with ONEOK was for fixed capacity fees.

Geothermal Facilities

The following operating data represents the aggregate capacity and electricity production at the geothermal facilities:

	Year Ended December 31,		
	2006	2005	2004
Overall capacity factor	92.7%	96.0%	91.6%
MWh produced	2,651,200	2,745,900	2,625,100
Capacity (net MW) (weighted average)	326.4	326.4	326.4

The \$12.9 million, or 5.8%, decrease in operating revenue at the geothermal facilities in 2006 primarily reflects \$5.4 million of lower revenue from a 3.4% decrease in energy production and a \$7.5 million decrease due to lower energy rates from lower index pricing mainly at the Salton Sea IV and V Projects. The energy production decrease primarily results from more extensive brine system and turbine overhaul outages and a wind storm event causing downed power poles and lines, which are not owned or maintained by the Imperial Valley Projects. This wind storm event caused forced downtime of approximately 3 days at certain Imperial Valley Projects

The \$14.7 million, or 7.1%, increase in operating revenue at the geothermal facilities in 2005 primarily reflects \$8.8 million of higher revenue from a 4.6% increase in energy production and an \$5.9 million increase due to favorable energy rates mainly at the Salton Sea IV and V Projects. The improvement in the overall capacity factor and MWh production resulted from more scheduled extensive brine system and turbine overhaul outages in 2004 compared to less extensive brine system and turbine overhauls in 2005. The major overhauls consist of more extensive repairs and are longer in duration. The overhaul schedules vary from year to year and are generally scheduled at intervals based on plant operating hours.

Fuel Expense

Both the Saranac and Yuma Projects supply the natural gas used by their facilities to produce energy under their existing power purchase agreements. Under the Power Resources Project's contract with ONEOK, its one-year energy management services agreement with Mpower, and its contract with Constellation, which was effective January 11, 2007, the marketer is required to procure the natural gas supply.

Fuel expense decreased \$4.8 million, or 4.4%, to \$103.8 million for the year ended December 31, 2006 from \$108.6 million for the same period in 2005. During 2006, the Company incurred \$3.2 million less in fuel expense due to the scheduled maintenance event at the Yuma Project and \$2.5 million less in fuel expense due to lower unit costs paid for natural gas. These 2006 decreases were offset partially by a \$0.9 million increase in fuel expense resulting from higher production at the Saranac Project.

Fuel expense increased \$16.5 million, or 17.9%, to \$108.6 million for the year ended December 31, 2005 from \$92.1 million for the same period in 2004. During 2005, the Company incurred \$12.6 million more in fuel expense due to higher unit costs paid for natural gas, while the remaining \$3.9 million increase resulted from higher production at both the Saranac and Yuma Projects.

Plant Operations

Plant operations increased \$15.6 million, or 13.0%, to \$135.6 million for the year ended December 31, 2006 from \$120.0 million for the same period in 2005. The increase was primarily due to an \$18.8 million increase in maintenance expense due to scheduled outages at the Yuma and Power Resources Projects as well as more extensive brine system overhauls, turbine overhauls and maintenance repairs at the Imperial Valley Projects and the Saranac Project in 2006. These increases were partially offset by a \$3.6 million decrease in hazardous waste liability due to the enactment of SB 1294.

Plant operations decreased \$13.9 million, or 10.4%, to \$120.0 million for the year ended December 31, 2005 from \$133.9 million for the same period in 2004. The decrease was primarily due to a \$14.9 million reduction in maintenance expense due to the timing and scope of scheduled outages, which included less extensive maintenance repairs at the Imperial Valley Projects and the Saranac Project in 2005. That decrease was partially offset by a \$2.0 million increase in Imperial Valley Project well workover expense in 2005, a \$1.0 million increase in Imperial Valley Project royalty expense due to higher 2005 revenues, and smaller increases relating to brine disposal costs, acid costs and other chemical costs all due to increased plant operations due to less extensive scheduled maintenance in 2005.

Depreciation and Amortization

Depreciation and amortization increased \$8.4 million to \$96.4 million for the year ended December 31, 2006 from \$88.0 million for the same period in 2005. The increase was due primarily to the aforementioned \$5.4 million increase in depreciation related to the change in an accounting estimate at the Saranac Project and a change in useful lives on brine production pipelines at certain Imperial Valley Projects.

Depreciation and amortization decreased \$2.9 million to \$88.0 million for the year ended December 31, 2005 from \$90.9 million for the same period in 2004. The decrease was due to a \$2.4 million decrease in disposals of certain replaced pipe at the Imperial Valley Projects in 2005 and a \$3.3 million decrease in Power Resources' depreciation as a result of the partial impairment of long-lived assets and full amortization of the long-term contract in 2004, partially offset by a \$1.0 million increase related to capital additions.

Asset Impairment

During 2004, management determined that a portion of the carrying value of the Power Resources' long-lived assets was no longer recoverable. As a result, the Company recognized a non-cash impairment charge of \$54.5 million, \$33.5 million after-tax, to write down the long-lived assets to their fair value. The fair value was determined based on discounted estimated cash flows from the future use of the long-lived assets. The impairment charge will not result in any current or future cash expenditures.

Interest Expense

Interest expense decreased \$5.3 million to \$50.5 million for the year ended December 31, 2006 and \$5.7 million to \$55.8 million for the year ended December 31, 2005. The decreases were due to lower outstanding debt balances.

Provision (Benefit) for Income Taxes

The provision for income taxes decreased \$10.2 million to \$11.1 million for the year ended December 31, 2006, from \$21.3 million for the same period in 2005. The effective tax rates were 11.9% and 18.8% in 2006 and 2005, respectively. The lower effective tax rate in 2006 was due primarily to the effects of the permanent depletion and energy tax credits representing a larger percentage of the income before income taxes for 2006 compared to the same period in 2005.

The provision for income taxes increased \$32.9 million to \$21.3 million for the year ended December 31, 2005, from a benefit of \$11.6 million for the same period in 2004. The effective tax rates were 18.8% and (156.8)% in 2005 and 2004, respectively. The lower effective tax rate in 2005 was due primarily to the effects of the permanent depletion and energy tax credits representing a smaller percentage of the income before income taxes for 2005 compared to the same period in 2004.

Liquidity and Capital Resources

Each of CE Generation's direct or indirect subsidiaries is organized as a legal entity separate and apart from CE Generation and its other subsidiaries. Pursuant to separate project financing agreements applicable to the Imperial Valley Projects and the Saranac Project, the assets of each subsidiary with a direct or indirect ownership interest in the Imperial Valley Projects other than Magma Power Company and Salton Sea Power Company and each subsidiary with a direct ownership interest in the subsidiary that owns interests in the Saranac Project are pledged or encumbered to support or otherwise provide the security for their own project or subsidiary debt, therefore it should not be assumed that any of these assets will be available to satisfy the obligations of CE Generation or any of its other subsidiaries; provided, however, that unrestricted cash or other assets which are available for distribution may, subject to applicable law and the terms of financing arrangements for such parties, be advanced, loaned, paid as dividends or otherwise distributed or contributed to CE Generation or affiliates thereof.

The Company generated cash flows from operations of \$144.5 million for the year ended December 31, 2006 compared with \$138.3 million for the same period in 2005. The increase was due primarily to favorable working capital changes, most notably resulting from lower accounts receivable balances due to the timing of customer payments at the Yuma Project.

Cash flows used in investing activities were \$21.6 million for the year ended December 31, 2006 compared with \$32.2 million for the same period in 2005. The change is primarily due to the timing of purchases and sales of available-for-sale securities generated in the Company's cash management program and decreased capital expenditures. Capital expenditures decreased to \$27.3 million for the year ended December 31, 2006 from \$30.8 million for the same period in 2005. Capital expenditures decreased in 2006 due primarily to the 2005 expansion of the Desert Valley Landfill. Forecasted capital expenditures for 2007 are \$33.9 million. Capital expenditure needs are reviewed regularly by management and may change significantly as a result of such reviews. The Company has decided to purchase pipeline replacement materials which are expected to have a longer useful life than the material currently used. The new material would result in higher capital expenditures than historical expenditures in 2007 though 2009. The Company expects to meet these capital expenditures with cash flows from operations.

Cash flows used in financing activities were \$117.2 million for the year ended December 31, 2006 compared with \$97.9 million for the same period in 2005. The increase is primarily due to increased cash distributions to owners and scheduled debt repayments.

Environmental Matters

The Company is subject to federal, state, local and foreign laws and regulations regarding air and water quality, hazardous and solid waste disposal and other environmental matters and believes it is in material compliance with current environmental requirements.

Air Quality

In March 2005, the United States Environmental Protection Agency (the "EPA"), released the final Clean Air Interstate Rule ("CAIR"), calling for reductions of sulfur dioxide and nitrogen oxides emissions ("NO_x") in the eastern United States through, at each state's option, a market-based cap and trade system, emission reductions, or both. The state of New York, where the Saranac Project is located, has been determined by the EPA to significantly contribute to nonattainment of the fine particulate standard in Pennsylvania, New Jersey, Connecticut and Delaware and to nonattainment of the ozone standard in Connecticut, New Jersey and Rhode Island. Similarly, the state of Texas, where the Power Resources Project is located, has been determined by the EPA to significantly contribute to nonattainment of the fine particulate standard in Illinois. Under the final CAIR, the first phase reductions of NO_x emissions are effective on January 1, 2009, and the second phase reductions are effective January 1, 2015. Depending on the outcome of CAIR litigation and implementation of the CAIR by New York and Texas, the CAIR emission reduction requirements could impact the Saranac and Power Resources Projects.

The CAIR could, in whole or in part, be superseded or made more stringent by current or future regulatory and legislative proposals at the federal or state levels that would result in significant reductions of SO₂ and NO_x, as well as carbon dioxide and other gases that may affect global climate change. In addition to any federal rules or legislation that could be enacted, the CAIR could be changed or overturned as a result of litigation. The sufficiency of the standards established by the CAIR has been legally challenged in the United States District Court of Appeals for the District of Columbia Circuit.

As a result of increased attention to climate change in the United States, numerous bills have been introduced in the current session of the United States Congress that would reduce greenhouse gas emissions in the United States. Congressional leadership has made climate change legislation a priority and many congressional observers expect to see the passage of climate change legislation within the next several years. While debate continues at the national level over the direction of domestic climate policy, several states have developed state-specific or regional legislative initiatives to reduce greenhouse gas emissions. For example, the states of Connecticut, Delaware, Maine, New Hampshire, New Jersey, New York and Vermont have signed a mandatory regional pact to reduce greenhouse gas emissions by ten percent from 1990 levels that would become effective in 2009. An executive order signed by California's governor in 2005 would reduce greenhouse gas emissions in that state to 2000 levels by 2010, to 1990 levels by 2020 and 80 percent below 1990 levels by 2050. In August 2006, California enacted a greenhouse gas emission performance standard applicable to all electricity generated within the state or delivered from outside the state that is no higher than the greenhouse gas emission levels of a state-of-the-art combined-cycle natural gas generation facility. California also adopted a statewide greenhouse gas emission cap to reduce greenhouse gas emissions by approximately 25% from 1990 levels by 2020. The outcome of federal and state climate legislation cannot be determined at this time; however, adoption of stringent limits on greenhouse gas emissions could

significantly impact the Company's natural gas-fired facilities, and, therefore, its financial results.

Refer to Note 10 of the Notes to Consolidated Financial Statements for additional information regarding commitments and litigation related to air quality standards and environmental remediation for contaminated sites.

Inflation

Inflation has not had a significant impact on CE Generation's costs.

Obligations and Commitments

The Company has contractual obligations and commercial commitments that may affect its financial condition. Contractual obligations to make future payments arise from long-term debt and fuel purchase contracts. Other obligations and commitments arise from standby letters of credit. Material obligations and commitments as of December 31, 2006, are as follows (in thousands):

	Payments Due by Period				
	Total	< 1 Year	2-3 Years	4-5 Years	>5 Years
Contractual Cash Obligations:					
Long-term debt	\$ 576,817	\$ 77,467	\$ 115,875	\$ 76,131	\$ 307,344
Interest payments on long-term debt	252,803	42,080	67,775	52,451	90,497
Natural gas contract commitments ⁽¹⁾	<u>188,986</u>	<u>74,137</u>	<u>114,849</u>	-	-
Total contractual cash obligations	<u>\$1,018,606</u>	<u>\$ 193,684</u>	<u>\$ 298,499</u>	<u>\$ 128,582</u>	<u>\$ 397,841</u>

⁽¹⁾ The natural gas contract commitments are not reflected in the accompanying Consolidated Balance Sheets.

A financial institution had issued for the account of CE Generation a debt service reserve letter of credit in the amount of \$24.2 million in favor of the holders of the Parent Senior Secured Bonds. On February 9, 2006, the previous \$24.2 million debt service reserve letter of credit was replaced by a letter of credit issued by a financial institution for the account of TransAlta USA Inc. and by a letter of credit issued by a separate financial institution for the account of MEHC. Each letter of credit is currently issued in the amount of \$12.1 million.

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 Consolidated Financial Statements.

Critical Accounting Policies

Certain accounting policies require management to make estimates and judgments concerning transactions that will be settled in the future. Amounts recognized in the financial statements from such estimates are necessarily based on numerous assumptions involving varying and potentially significant degrees of judgment and uncertainty. Accordingly, the amounts currently reflected in the financial statements will likely increase or decrease in the future as additional information becomes available. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of the Consolidated Financial Statements.

Impairment of Long-Lived Assets and Goodwill

The Company evaluates long-lived assets, including property, plant and equipment and intangible assets, when events or changes in circumstances indicate that the carrying value of these assets may not be recoverable or the assets meet the criteria of 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 discounted present value of the expected future cash flows from using the asset. Any resulting impairment loss is reflected in the Consolidated Statement 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, but are not limited to, significant changes in the market price of the asset, the use of the asset, management's plans, legal factors, the business climate or the physical condition of the asset. An impairment analysis of generating facilities requires estimates of possible future market prices, load growth, competition and many other factors over the lives of the facilities. Any resulting impairment loss is highly dependent on those underlying assumptions and could significantly affect the Company's results of operations.

The Company's Consolidated Balance Sheet as of December 31, 2006 includes goodwill of acquired businesses of \$265.9 million. Goodwill is allocated to each reporting unit and is tested for impairment using a variety of methods, principally discounted projected future net cash flows, at least annually and impairments, if any, are charged to earnings. The Company completed its annual review as of October 31. A significant amount of judgment is required in performing goodwill impairment tests. Key assumptions used in the testing include, but are not limited to, the use of an appropriate discount rate and estimated future cash flows. 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 cash flows, the Company incorporates current market information as well as historical factors.

During 2004, the Company recognized impairments on certain of its long-lived assets and goodwill. For additional discussion of these impairments, refer to Note 3 of Notes to Consolidated Financial Statements.

Income Taxes

In determining the Company's tax liabilities, management is required to interpret complex tax laws and regulations. In preparing tax returns, the Company is subject to continuous examinations by federal, state and local 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 Internal Revenue Service has closed examination of the Company's income tax returns through 2003. Although the ultimate resolution of the Company's federal and state tax examinations is uncertain, the Company believes it has made adequate provisions for these tax positions and the aggregate amount of any additional tax liabilities that may result from these examinations, if any, will not have a material adverse affect on the Company's financial results. The Company's provision for tax uncertainties is included in income tax payable and other long-term liabilities, as appropriate, in the accompanying Consolidated Balance Sheets.

Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

At December 31, 2006 and 2005, the Company had fixed-rate long-term debt of \$533.6 million and \$578.8 million, respectively, with a total fair value of \$553.6 million and \$621.0 million, respectively. Because of their fixed interest rates, these instruments do not expose the Company to the risk of earnings loss due to changes in market interest rates. However, the fair value of these instruments would decrease by approximately \$17 million and \$12 million, respectively, if interest rates were to increase by 10% from their levels at December 31, 2006 and 2005. In general, a decrease 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.

At December 31, 2006 and 2005, the Company had floating-rate obligations of \$43.2 million and \$74.3 million, respectively, that expose the Company to the risk of increased interest expense in the event of increases in short-term interest rates. The Company has entered into interest rate swap agreements for the purpose of completely offsetting these interest rate fluctuations. The interest rate differential is reflected as an adjustment to interest expense over the life of the instruments. At December 31, 2006 and 2005, these interest rate swaps had an aggregate notional amount of \$43.2 million and \$74.3 million, respectively, which the Company could terminate at a cost of \$0.6 million and \$2.3 million. A decrease of 10% in the December 31, 2006 and 2005 level of interest rates would increase the cost of terminating the swap agreements by \$0.1 million and \$0.5 million, respectively. These termination costs would impact the Company's earnings and cash flows only if all or a portion of the swap agreements were terminated prior to their expiration.

Commodity and Credit Risks

The Imperial Valley Projects' primary source of electricity revenue is derived from payments received pursuant to long-term power sales agreements with Edison. Because of the Imperial Valley Projects' dependence on Edison, if Edison fails to fulfill its obligations to the Imperial Valley Projects, it could significantly impair the ability of the Imperial Valley Projects 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 Imperial Valley Projects' electricity sales were to Edison in 2006.

In June and November 2001, Salton Sea II, Salton Sea III, Vulcan, Elmore, Leathers and Del Ranch, the Imperial Valley Projects 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 receive Edison's avoided cost of energy entered into amendments with Edison to their respective power purchase agreements which provide for a fixed energy price commencing May 1, 2007, and ending April 30, 2012. The amendments were approved by the CPUC and such approval became final on October 19, 2006. The energy price under the respective amended power purchase agreements during the fixed price period will be 6.15 cents per kWh, escalated 1% annually beginning May 1, 2008. Beginning May 1, 2012, the Imperial Valley Projects subject to these amendments will revert back to Edison's avoided cost of energy. There can be no assurances that the new Edison avoided cost of energy will result in revenues equivalent to the current fixed energy payments being received. For the years ended December 31, 2006, 2005 and 2004, Edison's average avoided cost of energy was 6.9 cents per kWh, 7.7 cents per kWh and 5.9 cents per kWh, respectively. Estimates of Edison's future avoided cost of energy vary substantially from year to year primarily based on the future cost of natural gas and may be impacted by regulatory proceedings and other commodity factors.

Approximately 83% of the natural gas-fired facilities electricity sales were to NYSEG in 2006.

CERTIFICATION

I, Stephen A. Larsen, certify that:

1. I have reviewed this annual report of CE Generation, LLC;
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 officers and I are responsible for establishing and maintaining disclosure controls and procedures for CE Generation, LLC 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 (the Company's fourth quarter in the case of an annual report) 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 officers 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 29, 2007

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

CERTIFICATION

I, Stephen D. Dickas, certify that:

1. I have reviewed this annual report of CE Generation, LLC;
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 officers and I are responsible for establishing and maintaining disclosure controls and procedures for CE Generation, LLC 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 (the Company's fourth quarter in the case of an annual report) 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 officers 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 29, 2007

/s/ Stephen D. Dickas
Stephen D. Dickas
Controller
(chief financial officer)