



# SALTON SEA FUNDING CORPORATION AND GUARANTORS

## **Combined Financial Statements**

**As of December 31, 2005 and 2004 and for each of the**

**Three Years in the Period Ended December 31, 2005**

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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying combined balance sheets of Salton Sea Funding Corporation and Guarantors (the "Company") as of December 31, 2005 and 2004, and the related combined statements of operations, of owners' equity, and of cash flows for each of the three years in the period ended December 31, 2005. The combined financial statements include the accounts of the companies disclosed in Note 1. These companies are under common ownership and management. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule 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 combined financial statements present fairly, in all material respects, the financial position of Salton Sea Funding Corporation and Guarantors as of December 31, 2005 and 2004 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional combining financial statement information listed in the table of contents on page 2 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This additional information is the responsibility of the Company's management. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as whole.

/s/ Deloitte & Touche LLP

Omaha, Nebraska  
March 31, 2006

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINED BALANCE SHEETS**

(In thousands)

	As of December 31,	
	2005	2004
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 14,932	\$ 15,489
Short term investments	6,000	5,000
Trade accounts receivable	28,035	29,822
Trade accounts receivable from affiliate	4,244	1,285
Inventories	20,743	18,513
Prepaid expenses and other current assets	2,265	2,494
Total current assets	76,219	72,603
Properties, plants and equipment, net	599,336	626,251
Intangible assets, net	78,738	84,475
Deferred financing costs, net	3,556	4,624
Due from affiliates	1,387	257,569
Goodwill	86,992	86,992
<b>Total assets</b>	<b>\$ 846,228</b>	<b>\$ 1,132,514</b>
<b>LIABILITIES AND OWNERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 7,078	\$ 4,880
Accrued interest	1,734	1,914
Accrued environmental liabilities	2,830	4,165
Other accrued liabilities	10,951	16,088
Current portion of long-term debt	25,916	28,620
Total current liabilities	48,509	55,667
Senior secured notes and bonds	243,841	269,757
Deferred income taxes	94,040	98,458
Total liabilities	386,390	423,882
Commitments and contingencies (Note 8)		
Owners' equity	459,838	708,632
<b>Total liabilities and owners' equity</b>	<b>\$ 846,228</b>	<b>\$ 1,132,514</b>

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

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINED STATEMENTS OF OPERATIONS**  
(In thousands)

	<b>Year Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Operating revenue</b>	<u>\$ 221,578</u>	<u>\$ 206,870</u>	<u>\$ 186,351</u>
<b>Costs and expenses:</b>			
Royalty, operating, general and administrative expense	96,137	107,732	103,065
Depreciation and amortization	58,598	54,740	52,858
Goodwill impairment	<u>-</u>	<u>-</u>	<u>44,465</u>
Total costs and expenses	<u>154,735</u>	<u>162,472</u>	<u>200,388</u>
<b>Operating income (loss)</b>	<u>66,843</u>	<u>44,398</u>	<u>(14,037)</u>
<b>Other income (expense):</b>			
Interest expense	(22,956)	(25,666)	(27,962)
Interest and other income	<u>2,115</u>	<u>1,607</u>	<u>382</u>
Total other income (expense)	<u>(20,841)</u>	<u>(24,059)</u>	<u>(27,580)</u>
<b>Income (loss) from continuing operations before provision for income taxes</b>	46,002	20,339	(41,617)
Provision for income taxes	<u>2,643</u>	<u>446</u>	<u>3,796</u>
<b>Income (loss) from continuing operations</b>	43,359	19,893	(45,413)
Income (loss) from discontinued operations, net of tax (Note 3)	<u>7,634</u>	<u>(504,623)</u>	<u>(27,627)</u>
<b>Net income (loss)</b>	<u>\$ 50,993</u>	<u>\$ (484,730)</u>	<u>\$ (73,040)</u>

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

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINED STATEMENTS OF OWNERS' EQUITY**  
**FOR THE THREE YEARS ENDED DECEMBER 31, 2005**  
(In thousands)

<b>Balance, January 1, 2003</b>	\$ 1,017,305
Net loss	(73,040)
Equity contributions	50,614
<hr/>	
<b>Balance, December 31, 2003</b>	994,879
Net loss	(484,730)
Equity contributions	198,483
<hr/>	
<b>Balance, December 31, 2004</b>	708,632
Net income	50,993
Equity distributions	(299,787)
<hr/>	
<b>Balance, December 31, 2005</b>	\$ 459,838

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

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

(In thousands)

	<b>Year Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Cash flows from operating activities:</b>			
Income (loss) from continuing operations	\$ 43,359	\$ 19,893	\$ (45,413)
Adjustments to reconcile income (loss) from continuing operations to net cash flows from continuing operations:			
Depreciation and amortization	58,598	54,740	52,858
Deferred income taxes	(4,418)	(253)	3,856
Goodwill impairment	-	-	44,465
Amortization of deferred financing costs	1,068	1,246	1,416
Changes in other items:			
Trade accounts receivable	(1,491)	(784)	11,522
Inventories, prepaid expenses and other current assets	(2,014)	(1,178)	9
Accounts payable and other accrued liabilities	<u>(3,765)</u>	<u>3,780</u>	<u>5,590</u>
Net cash flows from continuing operations	91,337	77,444	74,303
Net cash flows from discontinued operations	<u>616</u>	<u>(12,679)</u>	<u>(24,518)</u>
Net cash flows from operating activities	<u>91,953</u>	<u>64,765</u>	<u>49,785</u>
<b>Cash flows from investing activities:</b>			
Capital expenditures, net of warranty settlement	(24,819)	(19,965)	(22,696)
Purchases of available-for-sale securities	(70,000)	(210,500)	(152,300)
Proceeds from sales of available-for-sale securities	<u>69,000</u>	<u>209,350</u>	<u>163,450</u>
Net cash flows from continuing operations	(25,819)	(21,115)	(11,546)
Net cash flows from discontinued operations	<u>6,423</u>	<u>943</u>	<u>(7,852)</u>
Net cash flows from investing activities	<u>(19,396)</u>	<u>(20,172)</u>	<u>(19,398)</u>
<b>Cash flows from financing activities:</b>			
Repayment of senior secured notes and bonds	(28,620)	(28,831)	(26,681)
Increase in due from affiliates	<u>(36,788)</u>	<u>(24,549)</u>	<u>(59,238)</u>
Net cash flows from continuing operations	(65,408)	(53,380)	(85,919)
Net cash flows from discontinued operations	<u>(7,706)</u>	<u>13,341</u>	<u>15,580</u>
Net cash flows from financing activities	<u>(73,114)</u>	<u>(40,039)</u>	<u>(70,339)</u>
<b>Net change in cash and cash equivalents</b>	(557)	4,554	(39,952)
<b>Cash and cash equivalents at beginning of year</b>	<u>15,489</u>	<u>10,935</u>	<u>50,887</u>
<b>Cash and cash equivalents at end of year</b>	<u>\$ 14,932</u>	<u>\$ 15,489</u>	<u>\$ 10,935</u>
<b>Supplemental disclosure:</b>			
Interest paid	<u>\$ 22,037</u>	<u>\$ 27,166</u>	<u>\$ 36,941</u>
Income taxes paid (refunded)	<u>\$ 7,386</u>	<u>\$ 1,799</u>	<u>\$ (60)</u>

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

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

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

Salton Sea Funding Corporation ("Funding Corporation"), which was formed on June 20, 1995, is a special purpose Delaware corporation and was organized for the sole purpose of acting as issuer of senior secured notes and bonds. On July 21, 1995, June 20, 1996 and October 31, 1998, Funding Corporation issued \$475.0 million, \$135.0 million and \$285.0 million, respectively, of separate series of Senior Secured Notes and Bonds (collectively, the "Securities"). Funding Corporation is a wholly-owned subsidiary of Magma Power Company ("Magma"), which in turn is wholly-owned by CE Generation, LLC ("CE Generation").

On March 3, 1999, MidAmerican Energy Holdings Company ("MEHC") sold 50% of its ownership interests in CE Generation to El Paso CE Generation Holding Company ("El Paso"). On January 29, 2003, TransAlta USA Inc. ("TransAlta"), a wholly-owned subsidiary of TransAlta Corporation, 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.

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

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

Magma owns all of the remaining 10% interests in each of the Elmore, Leathers and Del Ranch Projects. CEOC is entitled to receive from Magma, as payment for certain data and services provided by CEOC, all of the partnership distributions Magma receives with respect to its 10% ownership interests in each of the Elmore, Leathers and Del Ranch Projects and Magma's special distributions equal to 4.5% of total energy revenue from the Leathers Project. Given the assignment of these rights by Magma to CEOC, the 10% ownership interest in each of the Elmore, Leathers and Del Ranch Projects is reflected in the accompanying combined financial statements of Funding Corporation and the Guarantors (collectively, the "Company").

CalEnergy Minerals installed facilities near the Partnership Projects that were intended to recover zinc from the geothermal brine through an ion exchange, solvent extraction, electrowinning and casting process (the "Zinc Recovery Project"). Salton Sea Minerals Corp. owns 100% of the interests in CalEnergy Minerals and is an indirect wholly-owned subsidiary of MEHC. The Zinc Recovery Project ceased operations on September 10, 2004.

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

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

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

<u>Operating Project</u>	<u>Facility Net Capacity (MW)<sup>(1)</sup></u>	<u>Location</u>	<u>Purchase Power Agreement Expiration</u>	<u>Power Purchaser<sup>(2)</sup></u>
Salton Sea Projects:				
Salton Sea I Project	10	California	2017	Edison
Salton Sea II Project	20	California	2020	Edison
Salton Sea III Project	50	California	2019	Edison
Salton Sea IV Project	40	California	2026	Edison
Salton Sea V Project	<u>49</u>	California	Varies <sup>(3)</sup>	Various <sup>(3)</sup>
Total Salton Sea Projects	<u>169</u>			
Partnership Projects:				
Vulcan Project	34	California	2016	Edison
Elmore Project	38	California	2018	Edison
Leathers Project	38	California	2019	Edison
Del Ranch Project	38	California	2019	Edison
CE Turbo Project	<u>10</u>	California	2029	APS
Total Partnership Projects	<u>158</u>			
Total operating projects	<u>327</u>			

- (1) Represents the nominal net megawatt (“MW”) generating capability. Actual MW may vary depending on operating and reservoir conditions and plant design.
- (2) Southern California Edison Company (“Edison”) and Arizona Public Service (“APS”).
- (3) The Salton Sea V Project provides 20 MW to Riverside Public Utilities (“Riverside”) and the remaining capacity to TransAlta. Riverside has agreed to purchase all available capacity from the Salton Sea V Project beginning June 1, 2013.

## 2. Summary of Significant Accounting Policies

### Basis of Presentation

The combined financial statements include the accounts of Funding Corporation and the Salton Sea Guarantors, the Partnership Guarantors and the Royalty Guarantor (together, the “Guarantors”) as Funding Corporation and the Guarantors are entities under common control and management. All transactions and accounts between and among Funding Corporation and the Guarantors have been eliminated.

### Use of Estimates

Preparation of the combined financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ materially from management’s estimates.

### Cash and Cash Equivalents

The Company considers all investment instruments purchased with an original maturity of three months or less to be cash equivalents.

### Short-term Investments

As of December 31, 2005 and 2004, the Company had \$6.0 million and \$5.0 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. The carrying value of these instruments approximates their fair value.

### Inventories

Inventories consist of maintenance 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.

### Properties, Plants and Equipment, Net

Properties, plants and equipment are recorded at historical cost. The cost of major additions and betterments are capitalized, while replacements, maintenance, overhaul and well rework and repairs that do not improve or extend the lives of the respective assets are expensed. Depreciation is generally computed using the straight-line method based on economic lives. The Company believes the useful lives assigned to the depreciable assets, which generally range from 2 to 30 years, are reasonable.

On January 1, 2003, the Company adopted Statement of Financial Accounting Standard No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"), which requires that an asset retirement obligation ("ARO") be recognized for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. SFAS 143 requires that the fair value of a liability for an ARO be 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. Adoption of SFAS 143 had no effect on the Company's financial position, results of operations or cash flows.

On December 31, 2005, the Company adopted Financial Accounting Standards Board 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 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. Adoption of FIN 47 had no effect on the Company's financial position, results of operations or cash flows.

In adopting both SFAS 143 and FIN 47, the Company's review identified legal retirement obligations for power plant and well abandonment costs. 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.

### Intangible Assets, Net

The Company's intangible assets consist of acquired power sales agreements and royalty streams. The acquired power sales agreements are amortized using the straight-line method over the remaining contract periods, which have ranged from 4 to 30 years. The royalty streams have been assigned values separately for each of (1) the remaining portion of the fixed price periods of the Royalty Projects' power sales agreements and (2) the 20-year avoided cost periods of the Royalty Projects' power sales agreements and are amortized separately over such periods using the straight-line method.

### Impairment of Long-Lived Assets

The Company periodically evaluates long-lived assets, including properties, plants and equipment and intangible assets 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 carrying amount of a long-lived asset or intangible asset is reviewed to assess whether the recoverable amount has declined below its carrying amount. The recoverable amount is the estimated net future cash flows that the Company expects to recover from the future use of the asset, undiscounted and without interest, plus the asset's residual value on disposal. Where the recoverable amount of the long-lived asset or intangible asset is less than the carrying value, an impairment loss is recognized to write down the asset to its fair value that is based on discounted estimated cash flows from the future use of the asset.

### Goodwill

The provisions of SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), which establishes the accounting for acquired goodwill and other intangible assets, and provides that goodwill and indefinite-lived intangible assets will not be amortized, requires allocating goodwill to each reporting unit and testing for impairment using a two step approach. The goodwill impairment test is performed annually or whenever an event has occurred that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The Company completed its annual review pursuant to SFAS 142 as of October 31, 2005 and 2004, respectively, using a discounted cash flow methodology. No impairments were indicated as a result of the assessments.

The Company completed its 2003 annual review as of October 31, 2003, primarily using a discounted cash flow methodology as of October 31, 2003. Due to changes in prices and capital expenditure forecasts, the cash flow forecasts were revised. As a result of these revisions and the changes in the fair value of debt, the tests indicated goodwill impairment. Therefore, the Company completed its assessment of the implied fair value of goodwill and as a result recognized goodwill impairment as of October 31, 2003, of \$44.5 million.

### 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.

Approximately 86%, 87% and 90% of the Company's sales of electricity were to Edison in 2005, 2004 and 2003, respectively. The trade accounts receivable balances are primarily uncollateralized receivables from long-term power purchase contracts. At December 31, 2005 and 2004, the trade accounts receivable balance from Edison was \$27.0 million and \$26.6 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, 2005 and 2004, there was no allowance for doubtful accounts recorded.

### Income Taxes

Funding Corporation is included in the consolidated income tax returns with its parent and affiliates. The Guarantors are comprised of a combination of corporations, partnerships and limited liability companies. Those entities that are corporations are included in the consolidated income tax returns with their parent and affiliates. Income taxes for all taxable entities are provided on a separate return basis; however, these tax obligations will be remitted to the parent only to the extent cash flows are available

after operating expenses and debt service. The income or loss of each partnership or limited liability company for income tax purposes, along with any associated tax credits, is the responsibility of the individual partners or members.

Deferred tax assets and liabilities are recognized based on the difference between the financial statement and tax basis of assets and liabilities using estimated tax rates in effect for the year in which the differences are expected to reverse. The calculation of current and deferred income taxes requires management to apply judgment relating to the application of complex tax laws or related interpretations and uncertainties related to the outcome of tax audits. Changes in such factors may result in changes to management's estimates, which could require the Company to adjust its currently recorded tax assets and liabilities and record additional income tax expense or benefits.

#### Fair Value of Financial Instruments

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. Although management uses its best judgment in estimating the fair value of these financial instruments, there are inherent limitations in any estimation technique. Therefore, the fair value estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current transaction.

The methods and assumptions used to estimate fair value are as follows:

Debt instruments - The fair value of all debt instruments has been estimated based upon quoted market prices as supplied by third-party broker dealers, where available, or at the present value of future cash flows discounted at rates consistent with comparable maturities with similar credit risks.

Other financial instruments - All other financial instruments of a material nature are short-term and the fair value approximates the carrying amount.

### **3. Discontinued Operations - Mineral Assets and Zinc Recovery Project**

The Zinc Recovery Project began limited production during December 2002 and continued limited production until September 10, 2004. On September 10, 2004, management made the decision to cease operations of the Zinc Recovery Project. Based on this decision, a non-cash, after-tax impairment charge of \$481.4 million was recorded to write-off the Zinc Recovery Project, rights to quantities of extractable minerals, and allocated goodwill (collectively, the "Mineral Assets"). The charge and related activity of the Mineral Assets are classified separately as discontinued operations in the accompanying combined statements of operations and include the following (in thousands):

	<b>Year Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
Operating revenue	\$ -	\$ 3,401	\$ 659
Losses from discontinued operations	\$ -	\$ (32,813)	\$ (46,596)
Proceeds from (costs of) disposal activities, net	7,634	(4,134)	-
Asset impairment charges	-	(454,830)	-
Goodwill impairment charges	-	(43,125)	-
Income tax (expense) benefit	-	30,279	18,969
Income (loss) from discontinued operations, net of tax	<u>\$ 7,634</u>	<u>\$ (504,623)</u>	<u>\$ (27,627)</u>

The income tax benefit in 2004 was impacted by the write-off of non tax deductible goodwill and the inability to utilize the net operating loss carryforward. The income tax expense in 2005 was zero due to prior net operating losses.

In connection with ceasing operations, the Zinc Recovery Project's assets have been dismantled and sold and certain employees of the operator of the Zinc Recovery Project were paid one-time termination benefits. Implementation of the decommissioning plan began in September 2004 and, as of December 31, 2005, the dismantling, decommissioning, and sale of remaining assets of the Zinc Recovery Project was complete.

The change in the balance of accrued disposal costs, which is included in other accrued liabilities in the accompanying combined balance sheets, for the years ended December 31 is summarized as follows (in thousands):

	<u>2005</u>	<u>2004</u>
Balance, January 1	\$ 430	\$ -
Costs of disposal activities	1,512	4,552
Payments of disposal costs	<u>(1,642)</u>	<u>(4,122)</u>
Balance, December 31	<u>\$ 300</u>	<u>\$ 430</u>

Costs of disposal activities, which consisted of disposal costs, termination benefit costs and property taxes, were recognized in the period in which the related liability was incurred.

Proceeds from disposal activities, which consisted mainly of salvage proceeds from the sale of assets and a settlement payment from a dispute with a contractor, were recognized in the period earned.

On December 13, 2004, CalEnergy Minerals entered into a project decommissioning contract (the "Decommissioning Contract") and an equipment purchase agreement (the "Equipment Purchase Agreement") with a third party contractor. Under the terms of the Decommissioning Contract, the contractor agreed to dismantle and remove certain Zinc Recovery Project equipment and other assets on a turnkey, date certain basis in exchange for the execution of the Equipment Purchase Agreement by CalEnergy Minerals. Under the terms of the Equipment Purchase Agreement the contractor purchased certain Zinc Recovery Project equipment for a guaranteed purchase price of \$4.1 million, which was paid in full as of April 19, 2005. Salvage proceeds from the sale of assets, including the \$4.1 million from the third party contractor, were \$6.4 million.

On May 25, 2001, CalEnergy Minerals and AMEC E&C Services Inc. ("AMEC") entered into a services agreement for engineering, procurement and construction management services (the "AMEC Agreement") in connection with the resolution of numerous problems that affected the timely completion of CalEnergy Minerals' Zinc Recovery Project. Under the AMEC Agreement, AMEC represented that it had certain licenses required for its services which CalEnergy Minerals ultimately determined to be false. AMEC submitted \$2.8 million of invoices to CalEnergy Minerals that AMEC claimed were due and payable under the AMEC Agreement. CalEnergy Minerals filed a lawsuit against AMEC on June 13, 2003, for declaratory judgment that would (1) prevent collection by AMEC of the \$2.8 million it claimed to be due and payable and (2) recover payments made by CalEnergy Minerals to AMEC based on AMEC's lack of a contractor's license in California. The lawsuit also included claims by CalEnergy Minerals against AMEC for breach of contract and breach of duty of fiduciary responsibility. In June 2005, CalEnergy Minerals and AMEC reached a settlement agreement, under which AMEC agreed to release its \$2.8 million claim and pay \$2.7 million to CalEnergy Minerals. CalEnergy Minerals received the \$2.7 million AMEC settlement payment on July 6, 2005.

MEHC contributed equity to CalEnergy Minerals to fund the Zinc Recovery Project's operating losses, capital expenditures and debt service through September 10, 2004, the date the Zinc Recovery Project's operations were ceased. Equity contributions in 2004 and 2003 were \$198.5 million and \$50.6 million, respectively, and are included in the accompanying combined statements of cash flows as part of net financing activity cash flows from discontinued operations. The equity contributions consist of MEHC's \$136.4 million funding of its guarantee of the 7.475% Senior Secured Series F Bonds due November 30, 2018, issued by Funding Corporation, which were redeemed on March 1, 2004, and MEHC's funding of the Zinc Recovery Project's operating losses totaling \$62.1 million and \$50.6 million, respectively, in 2004 and 2003.

#### 4. Properties, Plants and Equipment, Net

Properties, plants and equipment comprise the following at December 31 (in thousands):

	<u>Estimated Useful Lives</u>	<u>2005</u>	<u>2004</u>
Power plants	5 to 30 years	\$ 819,677	\$ 808,484
Wells and resource development	2 to 30 years	<u>226,357</u>	<u>220,010</u>
Total operating assets		1,046,034	1,028,494
Accumulated depreciation and amortization		<u>(446,698)</u>	<u>(402,243)</u>
Properties, plants and equipment, net		<u>\$ 599,336</u>	<u>\$ 626,251</u>

The Company replaced certain pipe in 2005, 2004 and 2003 with a remaining net book value of \$4.2 million, \$3.8 million and \$1.9 million, respectively, which was charged to depreciation expense in the accompanying combined statements of operations.

Stone & Webster, Inc. (“Stone & Webster”)

The Salton Sea V Project was constructed by Stone & Webster, pursuant to a date certain, fixed-price, turnkey engineering, procure, construct and manage contract (the “Salton Sea V Project EPC Contract”). On March 7, 2002, Salton Sea Power, the owner of the Salton Sea V Project, filed a Demand for Arbitration against Stone & Webster for breach of contract and breach of warranty arising from deficiencies in Stone & Webster’s design, engineering, construction and procurement of equipment for the Salton Sea V Project pursuant to the Salton Sea V Project EPC Contract. On April 25, 2003, Salton Sea Power entered into a settlement agreement with Stone & Webster. The Settlement Agreement resulted in a total payment of \$12.1 million from Stone & Webster in the second quarter 2003 and the arbitration was dismissed. The settlement was recorded as a \$4.5 million reduction of incremental capital expenditures and a \$7.6 million reduction of incremental operating expenses related to legal, other expenses and equipment write-offs.

**5. Intangible Assets, Net**

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

	<u>Estimated Useful Lives</u>	<u>2005</u>		<u>2004</u>	
		<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Power Purchase Contracts	4 to 30 years	\$ 216,935	\$ 163,314	\$ 216,935	\$ 159,330
Patented Technology	24 years	46,290	21,173	46,290	19,420
Total		<u>\$ 263,225</u>	<u>\$ 184,487</u>	<u>\$ 263,225</u>	<u>\$ 178,750</u>

Amortization expense on acquired intangible assets was \$5.6 million, \$5.7 million and \$5.7 million for the years ended December 31, 2005, 2004 and 2003, respectively. The Company expects amortization expense on acquired intangible assets to be \$5.7 million for each of the five succeeding fiscal years.

**6. Senior Secured Notes and Bonds**

Funding Corporation’s Securities consist of the following at December 31 as follows (in thousands):

<u>Issued Date</u>	<u>Senior Secured Series</u>	<u>Final Maturity Date</u>	<u>Rate</u>	<u>2005</u>	<u>2004</u>
July 21, 1995	B Bonds	May 30, 2005	7.37%	\$ -	\$ 21,504
July 21, 1995	C Bonds	May 30, 2010	7.84%	96,586	98,396
June 20, 1996	E Bonds	May 30, 2011	8.30%	36,572	40,072
October 13, 1998	F Bonds	November 30, 2018	7.48%	136,599	138,405
				<u>\$ 269,757</u>	<u>\$ 298,377</u>

Principal and interest payments are made in semi-annual installments. Annual repayments of Funding Corporation debt for the years ending December 31 are as follows (in thousands):

2006	\$ 25,916
2007	25,091
2008	28,065
2009	26,210
2010	26,741
Thereafter	137,734
Total	<u>\$ 269,757</u>

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, 2005.

The estimated fair values of the Securities at December 31, 2005 and 2004 were \$292.5 million and \$332.8 million, respectively.

## 7. Income Taxes

The provision (benefit) for income tax from continuing operations consists of the following for the years ended December 31 (in thousands):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Current:			
Federal	\$ 5,135	\$ (49)	\$ (264)
State	<u>1,926</u>	<u>748</u>	<u>204</u>
	<u>7,061</u>	<u>699</u>	<u>(60)</u>
Deferred:			
Federal	(3,381)	(24)	2,759
State	<u>(1,037)</u>	<u>(229)</u>	<u>1,097</u>
	<u>(4,418)</u>	<u>(253)</u>	<u>3,856</u>
Total	<u>\$ 2,643</u>	<u>\$ 446</u>	<u>\$ 3,796</u>

A reconciliation of the federal statutory tax rate to the effective tax rate applicable to income from continuing operations before provision (benefit) for income taxes follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Federal statutory rate	35.0%	35.0%	35.0%
Percentage depletion	(10.8)	(13.6)	5.0
Investment and energy tax credits	(3.1)	(8.9)	1.0
Domestic production deduction	(0.4)	-	-
State taxes, net of federal benefit	2.8	3.6	0.2
Partnership earnings	(17.7)	(13.9)	(29.6)
Goodwill impairment	-	-	(20.8)
Other items, net	<u>(0.1)</u>	<u>-</u>	<u>0.1</u>
Effective tax rate	<u>5.7%</u>	<u>2.2%</u>	<u>(9.1)%</u>

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

	<u>2005</u>	<u>2004</u>
<b>Deferred tax assets:</b>		
Accruals not currently deductible for tax purposes	\$ 3,357	\$ 3,691
Net operating loss carryforwards	24,027	25,653
Energy credit carryforwards	8,243	8,436
Alternative minimum tax credit carryforwards	<u>2,178</u>	<u>2,118</u>
Total deferred tax assets	<u>37,805</u>	<u>39,898</u>
<b>Deferred tax liabilities:</b>		
Properties, plants, contracts and equipment	<u>131,845</u>	<u>138,356</u>
Total deferred tax liabilities	<u>131,845</u>	<u>138,356</u>
Net deferred tax liability	<u>\$ 94,040</u>	<u>\$ 98,458</u>

Since the commencement of operations in December 2002, the Zinc Recovery Project incurred net operating losses, and accordingly, a deferred tax asset relating to the net operating loss carryforwards was recognized. At December 31, 2003, management believed based upon available evidence that the amount of the deferred tax asset recognized for net operating loss carryforwards would be realized through future taxable income generated by the Mineral Assets. On September 10, 2004, management made the decision to cease operations of the Zinc Recovery Project. In connection with ceasing the

operations and recognizing the non-cash impairment charge, the Company wrote-off the deferred tax asset related to the net operating loss carryforwards for Salton Sea Minerals Corporation as it became evident that the asset would not be recoverable through future taxable income of Salton Sea Minerals Corporation. The income tax benefit recorded in connection with the impairment charge represents the reversal of the book and tax basis differences related to properties, plant and equipment, net of the tax benefits previously recognized on operating losses.

The Company has a deferred tax asset on a federal net operating loss carryforward of \$21.7 million that begins to expire in 2021 unless previously utilized. The Company also has a deferred tax asset (net of federal benefit) on a California net operating loss carryforward of \$2.3 million that begins to expire in 2011 unless previously utilized.

The Company has a federal energy tax credit carryforward of \$8.2 million that begins to expire in 2020 unless previously utilized. The Company also has a federal alternative minimum tax credit carryforward of \$2.2 million that does not expire and will carryforward indefinitely until utilized.

## **8. Commitments and Contingencies**

### The California Power Exchange

In January 2001, the California Power Exchange declared bankruptcy. As a result, Salton Sea Power and CE Turbo did not receive payment for power sold to El Paso Merchant Energy Company (“EPME”) under certain transaction agreements during December 2000 and January 2001 of \$3.8 million (the “PX Receivable”). Salton Sea Power and CE Turbo established an allowance for doubtful accounts for this balance as of December 31, 2003. On September 29, 2004, Salton Sea Power and CE Turbo entered into separate Transfer of Claims Agreements 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, 2005, EPME had not made any payments in connection with the PX Receivable.

### Environmental

The Company is subject to numerous legislative and regulatory environmental protection requirements involving air and water pollution, waste management, hazardous chemical use, noise abatement, and land use aesthetics. State and federal environmental laws and regulations currently have, and future modifications may have, the effect of (i) increasing the lead time for the construction of new facilities, (ii) significantly increasing the total cost of new facilities, (iii) requiring modification of the Company’s existing facilities, (iv) increasing the risk of delay on construction projects, (v) increasing the Company’s cost of waste disposal and (vi) reducing the reliability of service provided by the Company and the amount of energy available from the Company’s facilities. Any of such items could have a substantial impact on amounts required to be expended by the Company in the future. Expenditures for ongoing compliance with environmental regulations that relate to current operations are expensed or capitalized as appropriate. Expenditures that relate to an existing condition caused by past operations, and which do not contribute to current or future revenue generation, are expensed. Liabilities are recorded when environmental assessments indicate that remediation efforts are probable and the costs can be reasonably estimated. Estimates of the liability are based upon currently available facts, existing technology and presently enacted laws and regulations taking into consideration the likely effects of inflation and other social and economic factors, and include estimates of associated legal costs. These amounts also consider prior experience in remediation of sites, other companies’ clean-up experience and data released by the Environmental Protection Agency or other organizations. These estimated liabilities are subject to revision in future periods based on actual costs or new circumstances, and are included in the combined balance sheets at their undiscounted amounts. As of December 31, 2005 and 2004, the environmental liabilities recorded in the accompanying combined balance sheets were \$2.8 million and \$4.2 million, respectively.

## 9. Related Party Transactions

Funding Corporation made (received) equity distributions (contributions) of \$299.8 million, \$(198.5) million and \$(50.6) million, respectively, in 2005, 2004 and 2003. The equity distributions represent the operating losses and capital expenditures of certain Guarantors previously funded by amounts held in the revenue account of Funding Corporation and amounts previously transferred to Magma pursuant to the terms and conditions of the debt of Funding Corporation.

Pursuant to the Amended and Restated Easement Grant Deed and Agreement Regarding Rights for Geothermal Development dated February 23, 1994, as amended, the Salton Sea Guarantors acquired from Magma Land I, a wholly-owned subsidiary of Magma, rights to extract geothermal brine from the geothermal lease rights property which is necessary to operate the Salton Sea Guarantors' power generation facilities in return for 5% of all electricity revenue received by the Salton Sea Guarantors. The amounts expensed in 2005, 2004 and 2003 were \$5.8 million, \$5.3 million and \$3.4 million, respectively.

Pursuant to the Easement Grant Deeds and Agreements Regarding Rights for Geothermal Development dated March 14, 1988 and August 15, 1988, the Partnership Guarantors acquired from Magma rights to extract geothermal brine from the geothermal lease rights property which is necessary to operate the Leathers, Del Ranch and Elmore Projects in return for 17.333%, on a pro rata basis, of all energy revenue received by each project. The amounts expensed in 2005, 2004 and 2003 were \$9.7 million, \$9.1 million and \$9.5 million, respectively.

The Company participates in multi-employer pension plans sponsored by MidAmerican Energy Company, an indirect wholly-owned subsidiary of MEHC. The Company's contribution to the various plans was \$1.4 million, \$2.1 million and \$2.0 million in 2005, 2004 and 2003, respectively.

Pursuant to the Administrative Services Agreement dated April 1, 1993 with Magma (the "Magma Services Agreement"), Magma will provide administrative and management services to the Salton Sea Guarantors, excluding the Salton Sea IV Project and the Salton Sea V Project. Fees payable to Magma amount to 3% of all electricity revenue. The amounts expensed in 2005, 2004 and 2003 were \$1.5 million, \$1.4 million and \$1.2 million, respectively.

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

Commencing on March 27, 2001, Salton Sea Power and CE Turbo entered into a series of transaction agreements to sell available power from the Salton Sea V Project and the CE Turbo Project to EPME based on percentages of the Dow Jones SP-15 Index. On February 11, 2003, Salton Sea Power and CE Turbo ceased selling available power to EPME. Pursuant to these transaction agreements, sales to EPME totaled \$1.2 million in 2003.

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 \$16.4 million, \$10.5 million and \$9.9 million in 2005, 2004 and 2003, respectively. Effective January 27, 2006, CE Turbo has terminated the TransAlta Transaction Agreement and begun deliveries to APS under a power sales agreement through December 31, 2029. CE Turbo will provide 10 MW to APS at an initial energy rate of \$80 per megawatt hour ("MWh") for on-peak hours during summer months (June - September) and \$55.55 per MWh for all other hours. The energy rates are increased throughout the term of the agreement, reaching a high on June 1, 2024 of \$110 per MWh for on-peak hours during summer months and \$77.83 per MWh for all other hours. As of December 31, 2005 and 2004, accounts receivable balances from TransAlta were \$4.1 million and \$1.3 million, respectively. Salton Sea Power has notified TransAlta that the TransAlta Transaction Agreement will terminate on June 1, 2013, at which point all available power will be purchased by Riverside.

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 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 and \$0.5 million in 2005 and 2004, respectively. As of December 31, 2005 and 2004, accounts receivable balances from TransAlta Marketing were \$0.2 million and \$- 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 during the periods included in the accompanying combined statements of operations. This discussion should be read in conjunction with Salton Sea Funding Corporation's ("Funding Corporation") and the Guarantors' (collectively, the "Company") historical combined financial statements and the related notes thereto. The Company's actual results in the future could differ significantly from the historical results.

The Guarantors' consist of the following legal entities:

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

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

### Forward-Looking Statements

From time to time, the Company may make forward-looking statements that involve judgments, assumptions and other uncertainties beyond the control of the Company or any of its subsidiaries individually. These forward-looking statements may include, among others, statements concerning revenue and cost trends, cost recovery, cost reduction strategies and anticipated outcomes, pricing strategies, changes in the utility industry, planned capital expenditures, financing needs and availability, statements of the Company's expectations, beliefs, future plans and strategies, anticipated events or trends and similar comments concerning matters that are not historical facts. These types of forward-looking statements are based on current expectations and involve a number of known and unknown risks and uncertainties that could cause the actual results and performance of the Company to differ materially from any expected future results or performance, expressed or implied, by the forward-looking statements. The Company has identified important factors that could cause actual results to differ materially from those expectations, including weather effects on revenues and other operating uncertainties, uncertainties relating to economic and political conditions and uncertainties regarding the impact of regulations, changes in government policy and competition. The Company does not assume any responsibility to update forward-looking information contained herein.

### Executive Summary

The following significant events occurred during the years ended December 31, 2005, 2004 and 2003, respectively, 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:

- The Company's Imperial Valley Projects had more extensive brine system and turbine overhauls in 2004 compared to less extensive brine system overhauls 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.

- On September 10, 2004, management made the decision to cease operations of the facilities installed near the geothermal energy generation facilities located in the Imperial Valley of California that were intended to recover zinc from the geothermal brine through an ion exchange, solvent extraction, electrowinning and casting process (the “Zinc Recovery Project”). Based on this decision, the Company recognized an impairment charge to write-off the Zinc Recovery Project, rights to quantities of extractable minerals and allocated goodwill.
- The Salton Sea III and Salton Sea IV Projects had uncontrollable force events in 2003.
- On March 1, 2004, Funding Corporation redeemed \$136.4 million of its 7.475% Senior Secured Series F Bonds (“Series F Bonds”) and collected \$136.4 million under Funding Corporation’s demand on MidAmerican Energy Holdings Company (“MEHC”).
- The Salton Sea V Project reached a settlement agreement in April 2003 with Stone & Webster Inc. (“Stone & Webster”), which resulted in the receipt of \$12.1 million from Stone & Webster. The settlement was recorded as a \$4.5 million reduction of incremental capital expenditures and a \$7.6 million reduction of incremental operation expenditures.

## Results of Operations

### *Operating Revenue*

The capacity factor for a particular project is determined by dividing the total quantity of electricity sold by the product of the project's capacity and the total hours in the year. Refer to Note 1 of Notes to Combined Financial Statements for the net capacity of each facility. Each plant possesses an operating margin, which allows for production in excess of a 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.

The following operating data represents the aggregate capacity and electricity production of the Imperial Valley Projects:

	<b>Year Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
Overall capacity factor	96.0%	91.6%	84.6%
MWh produced	2,745,900	2,625,100	2,417,700
Capacity (net MW) (weighted average)	326.4	326.4	326.4

Operating revenue increased \$14.7 million, or 7.1%, to \$221.6 million for the year ended December 31, 2005, from \$206.9 million for the same period in 2004. The increase primarily reflects \$7.4 million of higher revenue from a 4.6% increase in energy production and a \$8.4 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 major brine system and turbine overhaul outages in 2004 compared to mini-brine system overhauls and minor 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.

Operating revenue increased \$20.5 million, or 11.0%, to \$206.9 million for the year ended December 31, 2004 from \$186.4 million for the same period in 2003. The increase primarily reflects \$14.3 million of higher revenue from a 8.6% increase in energy production and a \$6.4 million increase due to favorable energy rates mainly at the Salton Sea V Project. The improvement in the overall capacity factor and MWh production resulted from uncontrollable force events at the Salton Sea III Project and the Salton Sea IV Project and other extended scheduled maintenance outages which resulted in lower energy production in 2003. The Salton Sea IV Project’s 40 MW turbine went out of service beginning July 10, 2003 and returned to service on September 17, 2003. The Salton Sea III Project’s 50 MW turbine went out of service beginning October 9, 2003, and returned to service on December 12, 2003.

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

Royalty, operating, general and administrative expense decreased \$11.6 million, or 10.8%, to \$96.1 million for the year ended December 31, 2005 from \$107.7 million for the same period in 2004. The decrease was primarily due to an \$11.6 million reduction in maintenance expense due to the timing and scope of scheduled outages, which included less extensive maintenance repairs at the projects in 2005. That decrease was partially offset by a \$2.0 million increase in well workover expense in 2005, a \$1.0 million increase in 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.

Royalty, operating, general and administrative expense increased \$4.6 million, or 4.5%, to \$107.7 million for the year ended December 31, 2004, from \$103.1 million for the same period in 2003. The increase was primarily due to the \$7.6 million settlement of a warranty claim with Stone & Webster received in 2003, partially offset by increased well workover and overhaul costs of \$2.9 million at the projects in 2004.

### *Depreciation and Amortization*

Depreciation and amortization increased \$3.9 million to \$58.6 million for the year ended December 31, 2005 and \$1.8 million to \$54.7 million for the year ended December 31, 2004, from \$52.9 million for the same period in 2003. The increases were primarily due to an increase in disposals of certain replaced pipe at the projects in 2005 and 2004.

### *Goodwill Impairment*

In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), the Company completed its annual goodwill impairment test, primarily using a discounted cash flow methodology as of October 31, 2003. Due to changes in prices and capital expenditure forecasts, the cash flow forecasts were revised. The Company completed its assessment of the implied fair value of goodwill and as a result of these tests, the Company recognized a goodwill impairment of \$44.5 million in the fourth quarter of 2003.

### *Interest Expense*

Interest expense decreased \$2.7 million to \$23.0 million for the year ended December 31, 2005, and \$2.3 million to \$25.7 million for the year ended December 31, 2004. The decreases are due to lower outstanding debt balances during 2005 and 2004.

### *Provision (Benefit) for Income Taxes*

The provision for income taxes increased \$2.2 million to \$2.6 million for the year ended December 31, 2005, from \$0.4 million for the same period in 2004. Income tax expense increased due to the increase in pre-tax income. The effective tax rate was 5.7% and 2.2% in 2005 and 2004, respectively. The energy tax credits (net of basis adjustments) were \$1.1 million and \$0.7 million for 2005 and 2004, respectively, and the depletion deductions were \$5.0 million and \$2.8 million for 2005 and 2004, respectively. The income before income taxes for 2005 and 2004 was \$46.0 million and \$20.3 million, respectively. Therefore, the permanent depletion and energy tax credits represented a smaller percentage of the income before income taxes for 2005 compared to the same period in 2004.

The provision for income taxes decreased \$3.4 million to \$0.4 million for the year ended December 31, 2004, from \$3.8 million for the same period in 2003. The effective tax rate was 2.2% and (9.1%) in 2004 and 2003, respectively. Changes in the effective rate primarily reflect lower pre-tax income in 2003 and the corresponding effect of depletion and energy tax credits as a percentage of pre-tax income.

### *Discontinued Operations*

On September 10, 2004, management made the decision to cease operations of the Zinc Recovery Project. In connection with ceasing operations, the Zinc Recovery Project's assets have been dismantled and sold and certain employees of the operator of the Zinc Recovery Project were paid one-time termination benefits. Implementation of the decommissioning plan began in September 2004 and, as of December 31, 2005, the dismantling, decommissioning, and sale of remaining assets of the Zinc Recovery Project was completed. The income tax benefit in 2004 was impacted by the write-off of non tax deductible goodwill and the inability to utilize the net operating loss carryforward. The income tax expense in 2005 was zero due to prior net operating losses.

The income from discontinued operations, net of income tax, of \$7.6 million for the year ended December 31, 2005, reflects the proceeds received from the sale of assets, partially offset by the disposal costs incurred, in connection with the September 2004 decision to cease the operations of the Zinc Recovery Project. The loss from discontinued operations, net of income tax, of \$504.6 million for the year ended December 31, 2004, consists primarily of an after-tax impairment charge of \$481.4 million recognized in connection with ceasing the operations of the Zinc Recovery Project. The \$27.6 million loss from discontinued operations, net of income tax, for the year ended December 31, 2003, reflects losses incurred from operating the Zinc Recovery Project.

### Liquidity and Capital Resources

The Company generated cash flows from operations of \$92.0 million for the year ended December 31, 2005, compared with \$64.8 million for the same period in 2004. The increase was due primarily to the favorable operating results previously discussed, the timing of working capital uses, and a \$13.3 million reduction in 2005 of cash used at the Zinc Recovery Project's discontinued operations.

Cash flows used in investing activities were \$19.4 million for the year ended December 31, 2005, compared with \$20.2 million for the same period in 2004. The change is primarily due to asset sale proceeds from the Zinc Recovery Project, which is largely offset by increased capital expenditures, as described below.

Capital expenditures increased to \$24.8 million for the year ended December 31, 2005, from \$20.0 million for the same period in 2004. Capital expenditures increased in 2005 due to increased capital pipe replacement in 2005. Forecasted capital expenditures for 2006 are \$33.9 million. Capital expenditure needs are reviewed regularly by management and may change significantly as a result of such reviews. The Company expects to meet these capital expenditures with cash flows from operations.

Cash flows used in financing activities were \$73.1 million for the year ended December 31, 2005, compared with \$40.0 million for the same period in 2004. The increase is primarily due to activity associated with the Zinc Recovery Project's discontinued operations.

On March 1, 2004, Funding Corporation completed the redemption of an aggregate principal amount of \$136.4 million of the Series F Bonds, pro rata, at a redemption price of 100% of such aggregate outstanding principal amount, plus accrued interest to the date of redemption. Funding Corporation also made a demand on MEHC, and MEHC performed under that demand, for the full amount remaining on MEHC's guarantee of the Series F Bonds in order to fund the redemption. Given the payment under MEHC's guarantee, MEHC no longer has any liability with respect to its guarantee.

### Environmental Liabilities

The Company is subject to numerous legislative and regulatory environmental protection requirements involving air and water pollution, waste management, hazardous chemical use, noise abatement, and land use aesthetics. State and federal environmental laws and regulations currently have, and future modifications may have, the effect of (i) increasing the lead time for the construction of new facilities, (ii) significantly increasing the total cost of new facilities, (iii) requiring modification of the Company's existing facilities, (iv) increasing the risk of delay on construction projects, (v) increasing the Company's cost of waste disposal and (vi) reducing the reliability of service provided by the Company and the amount of energy available from the Company's facilities. Any of such items could have a substantial impact on amounts required to be expended by the Company in the future. Expenditures for ongoing compliance with environmental regulations that relate to current operations are expensed or capitalized as appropriate. Expenditures that relate to an existing condition caused by past operations, and which do not contribute to current or future revenue generation, are expensed. Liabilities are recorded when

environmental assessments indicate that remediation efforts are probable and the costs can be reasonably estimated. Estimates of the liability are based upon currently available facts, existing technology and presently enacted laws and regulations taking into consideration the likely effects of inflation and other social and economic factors, and include estimates of associated legal costs. These amounts also consider prior experience in remediation of sites, other companies' clean-up experience and data released by the Environmental Protection Agency or other organizations. These estimated liabilities are subject to revision in future periods based on actual costs or new circumstances, and are included in the combined balance sheets at their undiscounted amounts. As of December 31, 2005 and 2004, the environmental liabilities recorded in the accompanying combined balance sheets were \$2.8 million and \$4.2 million, respectively.

### Inflation

Inflation has not had a significant impact on the Company's cost structure.

### 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. Material obligations and commitments as of December 31, 2005, are as follows (in thousands):

	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>&lt; 1 Year</b>	<b>2-3 Years</b>	<b>4-5 Years</b>	<b>&gt;5 Years</b>
Contractual Cash Obligations:					
Long-term debt	\$ 269,757	\$ 25,916	\$ 53,156	\$ 52,951	\$ 137,734
Interest payments on long-term debt	<u>123,023</u>	<u>20,310</u>	<u>34,544</u>	<u>25,893</u>	<u>42,276</u>
Total contractual cash obligations	<u>\$ 392,780</u>	<u>\$ 46,226</u>	<u>\$ 87,700</u>	<u>\$ 78,844</u>	<u>\$ 180,010</u>

### 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

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported in the combined financial statements and accompanying notes. Note 2 to the combined financial statements for the year ended December 31, 2005, in this annual report describes the significant accounting policies and methods used in the preparation of the combined financial statements. Estimates are used for, but not limited to, the accounting for the allowance for doubtful accounts, impairment of long-lived assets and goodwill and income taxes. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of the combined financial statements.

#### *Allowance for Doubtful Accounts*

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.

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

The Company's long-lived assets consist primarily of properties, plants and equipment. Depreciation is generally computed using the straight-line method based on economic lives. The Company periodically evaluates long-lived assets, including properties, plants and equipment, 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 carrying amount of a long-lived asset or intangible asset is reviewed to assess whether the recoverable amount has declined below its carrying amount. The recoverable amount is the estimated net future cash flows that the Company expects to recover from the future use of the asset, undiscounted and without interest, plus the asset's residual value on disposal. Where the recoverable amount of the long-lived asset or intangible asset is less than the carrying value, an impairment loss is recognized to write down the asset to its fair value that is based on discounted estimated cash flows from the future use of the asset.

The estimate of cash flows arising from future use of the asset that are used in the impairment analysis requires judgment regarding what the Company would expect to recover from future use of the asset. Any changes in the estimates of cash flows arising from future use of the asset or the residual value of the asset on disposal based on changes in the market conditions, changes in the use of the asset, management's plans, the determination of the useful life of the asset and technology changes in the industry could significantly change the calculation of the fair value or recoverable amount of the asset and the resulting impairment loss, which could significantly affect the results of operations. The determination of whether impairment has occurred is primarily based on an estimate of undiscounted cash flows attributable to the assets, as compared to the carrying value of the assets. 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. A resulting impairment loss is highly dependent on these underlying assumptions.

The Company evaluates the impairment of goodwill under SFAS 142. The Company performs an annual goodwill impairment test and updates the test if events or circumstances occur that would more likely than not reduce the fair value of a reporting unit below its carrying value. Key assumptions used in the analysis 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, assumptions regarding comprehensive energy regulation, changes in regulations and rates, and estimates of future commodity prices. In estimating cash flows, the Company incorporates current market information, as well as, historical factors.

### *Income Taxes*

Deferred tax assets and liabilities are recognized based on the difference between the financial statement and tax basis of assets and liabilities using estimated tax rates in effect for the year in which the differences are expected to reverse. The calculation of current and deferred income taxes requires management to apply judgment relating to the application of complex tax laws or related interpretations and uncertainties related to the outcome of tax audits. The Company also applies judgment in estimating the likelihood that net operating loss carryforwards will be utilized prior to expiration. Changes in such factors may result in changes to management's estimates, which could require the Company to adjust its currently recorded tax assets and liabilities and record additional income tax expense or benefits.

### Quantitative and Qualitative Disclosures About Market Risk

#### *Interest Rate Risk*

At December 31, 2005 and 2004, the Company had fixed-rate long-term debt of \$269.8 million and \$298.4 million, respectively, in aggregate principal amount and having a fair value of \$292.5 million and \$332.8 million, respectively. These instruments are fixed-rate and therefore 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 \$6.1 million and \$7.6 million, respectively, if interest rates were to increase by 10% from their levels at December 31, 2005 and 2004. 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.

### *Credit Risk*

The Projects' primary source of electricity revenue is derived from payments received pursuant to long-term power sales agreements with Southern California Edison ("Edison"). Because of the Projects' dependence on Edison, if Edison fails to fulfill its obligations to the Projects, it could significantly impair the ability of the 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.

In June and November 2001, the 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, 200, to April 30, 2002, and is 5.37 cents per kWh from May 1, 2002, through April 30, 2007. Proceedings are currently pending before the California Public Utilities Commission to review, and potentially modify or change, the current methodology used to determine Edison's avoided cost of energy that will be applicable to sales of energy after April 30, 2007. Beginning May 1, 2007, the 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, 2005, 2004 and 2003, Edison's average avoided cost of energy was 7.7 cents per kWh, 5.9 cents per kWh and 5.4 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.

### Other

On August 12, 2005, the Company filed a Form 15 with the U.S. Securities and Exchange Commission and immediately ceased its public filings of financial reports. On September 22, 2005, the Company obtained the requisite approval of the holders of the Securities to amend the reporting requirements in the indenture pursuant to which the Securities were issued (the "Indenture") to eliminate the historical requirement for the Company to present multiple financial statements and replace such requirement with one requiring only one combined financial statement for Funding Corporation and the Guarantors. Following the receipt of such approval, the Company and the trustee for the Securities effected such amendment. Combining financial statements that include Funding Corporation and the Guarantors are included in Exhibit A.

## CERTIFICATION

I, Stefan A. Bird, certify that:

1. I have reviewed this annual report of Salton Sea Funding Corporation and the Guarantors (collectively, the "Company");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures for Salton Sea Funding Corporation and the Guarantors and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and
5. The Company's other certifying 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 31, 2006

/s/ Stefan A. Bird  
Stefan A. Bird  
President  
(chief executive officer)

## CERTIFICATION

I, Stephen D. Dickas, certify that:

1. I have reviewed this annual report of Salton Sea Funding Corporation and the Guarantors (collectively, the "Company");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures for Salton Sea Funding Corporation and the Guarantors and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and
5. The Company's other certifying 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 31, 2006

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

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING BALANCE SHEET**

EXHIBIT A

**December 31, 2005**

(amounts in thousands)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ -	\$ 300	\$ -	\$ 14,632	\$ 14,932
Short term investments	-	-	-	6,000	6,000
Trade accounts receivable	13,841	14,194	-	-	28,035
Trade accounts receivable from affiliate	3,096	1,148	-	-	4,244
Inventories	-	20,743	-	-	20,743
Prepaid expenses and other current assets	1,064	1,105	-	96	2,265
Total current assets	<u>18,001</u>	<u>37,490</u>	<u>-</u>	<u>20,728</u>	<u>76,219</u>
Properties, plants and equipment, net	357,647	241,689	-	-	599,336
Intangible assets, net	21,571	46,343	10,824	-	78,738
Deferred financing costs, net	2,232	1,265	59	-	3,556
Due from affiliates	(3,044)	(790)	-	5,221	1,387
Goodwill	-	56,528	30,464	-	86,992
<b>Total assets</b>	<u>\$ 396,407</u>	<u>\$ 382,525</u>	<u>\$ 41,347</u>	<u>\$ 25,949</u>	<u>846,228</u>
<b>LIABILITIES AND OWNERS' EQUITY</b>					
Current liabilities:					
Accounts payable	\$ 1,384	\$ 5,694	\$ -	\$ -	\$ 7,078
Accrued interest	1,121	613	-	-	1,734
Accrued environmental liabilities	-	2,830	-	-	2,830
Other accrued liabilities	2,514	8,437	-	-	10,951
Current portion of secured project notes	22,621	3,295	-	(25,916)	-
Current portion of long-term debt	-	-	-	25,916	25,916
Total current liabilities	<u>27,640</u>	<u>20,869</u>	<u>-</u>	<u>-</u>	<u>48,509</u>
Secured project notes	152,700	91,141	-	(243,841)	-
Senior secured notes and bonds	-	-	-	243,841	243,841
Deferred income taxes	5,086	88,954	-	-	94,040
Total liabilities	<u>185,426</u>	<u>200,964</u>	<u>-</u>	<u>-</u>	<u>386,390</u>
Owners' equity	<u>210,981</u>	<u>181,561</u>	<u>41,347</u>	<u>25,949</u>	<u>459,838</u>
<b>Total liabilities and owners' equity</b>	<u>\$ 396,407</u>	<u>\$ 382,525</u>	<u>\$ 41,347</u>	<u>\$ 25,949</u>	<u>846,228</u>

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING BALANCE SHEET**  
**December 31, 2004**

EXHIBIT A (Continued)

(amounts in thousands)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ -	\$ 966	\$ -	\$ 14,523	\$ 15,489
Short term investments	-	-	-	5,000	5,000
Trade accounts receivable	14,872	14,950	-	-	29,822
Trade accounts receivable from affiliate	932	353	-	-	1,285
Inventories	-	18,513	-	-	18,513
Prepaid expenses and other current assets	1,335	1,146	-	13	2,494
Total current assets	<u>17,139</u>	<u>35,928</u>	<u>-</u>	<u>19,536</u>	<u>72,603</u>
Properties, plants and equipment, net	373,208	253,043	-	-	626,251
Intangible assets, net	22,721	49,841	11,913	-	84,475
Deferred financing costs, net	3,030	1,506	88	-	4,624
Due from affiliates	(14,625)	279,861	-	(7,667)	257,569
Goodwill	-	56,528	30,464	-	86,992
<b>Total assets</b>	<u>\$ 401,473</u>	<u>\$ 676,707</u>	<u>\$ 42,465</u>	<u>\$ 11,869</u>	<u>\$ 1,132,514</u>
<b>LIABILITIES AND OWNERS' EQUITY</b>					
Current liabilities:					
Accounts payable	\$ 786	\$ 4,094	\$ -	\$ -	\$ 4,880
Accrued interest	1,262	642	10	-	1,914
Accrued environmental liabilities	-	4,165	-	-	4,165
Other accrued liabilities	4,159	11,929	-	-	16,088
Current portion of secured project notes	22,787	4,265	1,568	(28,620)	-
Current portion of long-term debt	-	-	-	28,620	28,620
Total current liabilities	<u>28,994</u>	<u>25,095</u>	<u>1,578</u>	<u>-</u>	<u>55,667</u>
Secured project notes	175,319	94,438	-	(269,757)	-
Senior secured notes and bonds	-	-	-	269,757	269,757
Deferred income taxes	2,909	95,549	-	-	98,458
Total liabilities	<u>207,222</u>	<u>215,082</u>	<u>1,578</u>	<u>-</u>	<u>423,882</u>
Owners' equity	<u>194,251</u>	<u>461,625</u>	<u>40,887</u>	<u>11,869</u>	<u>708,632</u>
<b>Total liabilities and owners' equity</b>	<u>\$ 401,473</u>	<u>\$ 676,707</u>	<u>\$ 42,465</u>	<u>\$ 11,869</u>	<u>\$ 1,132,514</u>

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING STATEMENTS OF OPERATIONS**  
**For the Years Ended December 31, 2005**  
(amounts in thousands)

EXHIBIT A (Continued)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>Operating revenue</b>	\$ 115,004	\$ 106,574	\$ 12,840	\$ (12,840)	\$ 221,578
<b>Costs and expenses:</b>					
Royalty, operating, general and administrative expense	49,982	55,270	3,073	(12,188)	96,137
Depreciation and amortization	28,050	29,459	1,089	-	58,598
Total costs and expenses	<u>78,032</u>	<u>84,729</u>	<u>4,162</u>	<u>(12,188)</u>	<u>154,735</u>
<b>Operating income</b>	<u>36,972</u>	<u>21,845</u>	<u>8,678</u>	<u>(652)</u>	<u>66,843</u>
<b>Other income (expense):</b>					
Interest expense	(15,032)	(7,847)	(77)	-	(22,956)
Interest and other income	102	1,219	-	794	2,115
Total other income (expense)	<u>(14,930)</u>	<u>(6,628)</u>	<u>(77)</u>	<u>794</u>	<u>(20,841)</u>
<b>Income from continuing operations before income taxes</b>	22,042	15,217	8,601	142	46,002
Provision for income taxes	2,237	347	-	59	2,643
<b>Income from continuing operations</b>	<u>19,805</u>	<u>14,870</u>	<u>8,601</u>	<u>83</u>	<u>43,359</u>
Income from discontinued operations	-	7,634	-	-	7,634
<b>Net income</b>	<u>\$ 19,805</u>	<u>\$ 22,504</u>	<u>\$ 8,601</u>	<u>\$ 83</u>	<u>\$ 50,993</u>

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING STATEMENTS OF OPERATIONS**  
**For the Years Ended December 31, 2004**  
(amounts in thousands)

EXHIBIT A (Continued)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>Operating revenue</b>	\$ 104,953	\$ 101,917	\$ 12,045	\$ (12,045)	\$ 206,870
<b>Costs and expenses:</b>					
Royalty, operating, general and administrative expense	54,936	61,374	3,144	(11,722)	107,732
Depreciation and amortization	25,518	28,133	1,089	-	54,740
Total costs and expenses	<u>80,454</u>	<u>89,507</u>	<u>4,233</u>	<u>(11,722)</u>	<u>162,472</u>
<b>Operating income</b>	<u>24,499</u>	<u>12,410</u>	<u>7,812</u>	<u>(323)</u>	<u>44,398</u>
<b>Other income (expense):</b>					
Interest expense	(17,244)	(8,199)	(223)	-	(25,666)
Interest and other income	130	1,101	-	376	1,607
Total other income (expense)	<u>(17,114)</u>	<u>(7,098)</u>	<u>(223)</u>	<u>376</u>	<u>(24,059)</u>
<b>Income (loss) from continuing operations before income taxes</b>	7,385	5,312	7,589	53	20,339
Provision (benefit) for income taxes	2,762	(2,338)	-	22	446
<b>Income from continuing operations</b>	4,623	7,650	7,589	31	19,893
Loss from discontinued operations	(91,634)	(412,989)	-	-	(504,623)
<b>Net income (loss)</b>	<u>\$ (87,011)</u>	<u>\$ (405,339)</u>	<u>\$ 7,589</u>	<u>\$ 31</u>	<u>\$ (484,730)</u>

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

EXHIBIT A (Continued)

**For the Years Ended December 31, 2003**

(amounts in thousands)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>Operating revenue</b>	\$ 83,582	\$ 102,769	\$ 12,509	\$ (12,509)	\$ 186,351
<b>Costs and expenses:</b>					
Royalty, operating, general and administrative expense	57,606	54,469	3,216	(12,226)	103,065
Depreciation and amortization	26,233	25,616	1,009	-	52,858
Goodwill impairment	23,252	21,213	-	-	44,465
Total costs and expenses	<u>107,091</u>	<u>101,298</u>	<u>4,225</u>	<u>(12,226)</u>	<u>200,388</u>
<b>Operating income</b>	<u>(23,509)</u>	<u>1,471</u>	<u>8,284</u>	<u>(283)</u>	<u>(14,037)</u>
<b>Other income (expense):</b>					
Interest expense	(19,113)	(8,530)	(319)	-	(27,962)
Interest and other income	(357)	220	-	519	382
Total other income (expense)	<u>(19,470)</u>	<u>(8,310)</u>	<u>(319)</u>	<u>519</u>	<u>(27,580)</u>
<b>Income (loss) from continuing operations before income taxes</b>	(42,979)	(6,839)	7,965	236	(41,617)
Provision for income taxes	369	3,330	-	97	3,796
<b>Income (loss) from continuing operations</b>	<u>(43,348)</u>	<u>(10,169)</u>	<u>7,965</u>	<u>139</u>	<u>(45,413)</u>
Loss from discontinued operations	(46)	(27,581)	-	-	(27,627)
<b>Net income (loss)</b>	<u>\$ (43,394)</u>	<u>\$ (37,750)</u>	<u>\$ 7,965</u>	<u>\$ 139</u>	<u>\$ (73,040)</u>

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING STATEMENT OF CASH FLOWS**  
**For the Year Ended December 31, 2005**

EXHIBIT A (Continued)

(amounts in thousands)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>Cash flows from operating activities:</b>					
Income from continuing operations	\$ 19,805	\$ 14,870	\$ 8,601	\$ 83	\$ 43,359
Adjustments to reconcile income from continuing operations to net cash flows from continuing operations:					
Depreciation and amortization	28,050	29,459	1,089	-	58,598
Deferred income taxes	2,177	(6,595)	-	-	(4,418)
Amortization of deferred financing costs	798	241	29	-	1,068
Changes in other items:					
Trade accounts receivable	(1,133)	(358)	-	-	(1,491)
Inventories, prepaid expenses and other current assets	271	(2,202)	-	(83)	(2,014)
Accounts payable and accrued liabilities	(1,845)	(1,910)	(10)	-	(3,765)
Net cash flows from continuing operations	48,123	33,505	9,709	-	91,337
Net cash flows from discontinued operations	-	616	-	-	616
Net cash from operating activities	48,123	34,121	9,709	-	91,953
<b>Cash flows from investing activities:</b>					
Capital expenditures	(10,594)	(14,225)	-	-	(24,819)
Purchases of available-for-sale securities	-	-	-	(70,000)	(70,000)
Proceeds from sales of available-for-sale securities	-	-	-	69,000	69,000
Net cash flows from continuing operations	(10,594)	(14,225)	-	(1,000)	(25,819)
Net cash flows from discontinued operations	-	6,423	-	-	6,423
Net cash from investing activities	(10,594)	(7,802)	-	(1,000)	(19,396)
<b>Cash flows from financing activities:</b>					
Repayment of senior secured notes and bonds	(22,785)	(4,267)	(1,568)	-	(28,620)
(Increase) decrease in due from affiliates	(14,744)	(15,012)	(8,141)	1,109	(36,788)
Net cash flows from continuing operations	(37,529)	(19,279)	(9,709)	1,109	(65,408)
Net cash flows from discontinued operations	-	(7,706)	-	-	(7,706)
Net cash from financing activities	(37,529)	(26,985)	(9,709)	1,109	(73,114)
<b>Net change in cash and cash equivalents</b>	-	(666)	-	109	(557)
<b>Cash and cash equivalents at the beginning of period</b>	-	966	-	14,523	15,489
<b>Cash and cash equivalents at the end of period</b>	<u>\$ -</u>	<u>\$ 300</u>	<u>\$ -</u>	<u>\$ 14,632</u>	<u>\$ 14,932</u>

**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING STATEMENT OF CASH FLOWS**  
**For the Year Ended December 31, 2004**

EXHIBIT A (Continued)

(amounts in thousands)

	<u>Salton Sea</u> <u>Guarantors</u>	<u>Partnership</u> <u>Guarantors</u>	<u>Royalty</u> <u>Guarantor</u>	<u>Funding</u> <u>Corporation &amp;</u> <u>Eliminations</u>	<u>Combined</u>
<b>Cash flows from operating activities:</b>					
Income from continuing operations	\$ 4,623	\$ 7,650	\$ 7,589	\$ 31	\$ 19,893
Adjustments to reconcile income from continuing operations to net cash flows from continuing operations:					
Depreciation and amortization	25,518	28,133	1,089	-	54,740
Deferred income taxes	2,762	(3,015)	-	-	(253)
Amortization of deferred financing costs	952	258	36	-	1,246
Changes in other items:					
Trade accounts receivable	(603)	(181)	-	-	(784)
Inventories, prepaid expenses and other current assets	(262)	(908)	-	(8)	(1,178)
Accounts payable and accrued liabilities	(1,963)	5,752	(9)	-	3,780
Net cash flows from continuing operations	<u>31,027</u>	<u>37,689</u>	<u>8,705</u>	<u>23</u>	<u>77,444</u>
Net cash flows from discontinued operations	-	(12,679)	-	-	(12,679)
Net cash from operating activities	<u>31,027</u>	<u>25,010</u>	<u>8,705</u>	<u>23</u>	<u>64,765</u>
<b>Cash flows from investing activities:</b>					
Capital expenditures	(4,421)	(15,544)	-	-	(19,965)
Purchases of available-for-sale securities	-	-	-	(210,500)	(210,500)
Proceeds from sales of available-for-sale securities	-	-	-	209,350	209,350
Net cash flows from continuing operations	<u>(4,421)</u>	<u>(15,544)</u>	<u>-</u>	<u>(1,150)</u>	<u>(21,115)</u>
Net cash flows from discontinued operations	-	943	-	-	943
Net cash from investing activities	<u>(4,421)</u>	<u>(14,601)</u>	<u>-</u>	<u>(1,150)</u>	<u>(20,172)</u>
<b>Cash flows from financing activities:</b>					
Repayment of senior secured notes and bonds	(23,346)	(4,016)	(1,469)	-	(28,831)
(Increase) decrease in due from affiliates	(3,260)	(19,212)	(7,236)	5,159	(24,549)
Net cash flows from continuing operations	<u>(26,606)</u>	<u>(23,228)</u>	<u>(8,705)</u>	<u>5,159</u>	<u>(53,380)</u>
Net cash flows from discontinued operations	-	13,341	-	-	13,341
Net cash from financing activities	<u>(26,606)</u>	<u>(9,887)</u>	<u>(8,705)</u>	<u>5,159</u>	<u>(40,039)</u>
<b>Net change in cash and cash equivalents</b>	-	522	-	4,032	4,554
<b>Cash and cash equivalents at the beginning of period</b>	-	444	-	10,491	10,935
<b>Cash and cash equivalents at the end of period</b>	<u>\$ -</u>	<u>\$ 966</u>	<u>\$ -</u>	<u>\$ 14,523</u>	<u>\$ 15,489</u>

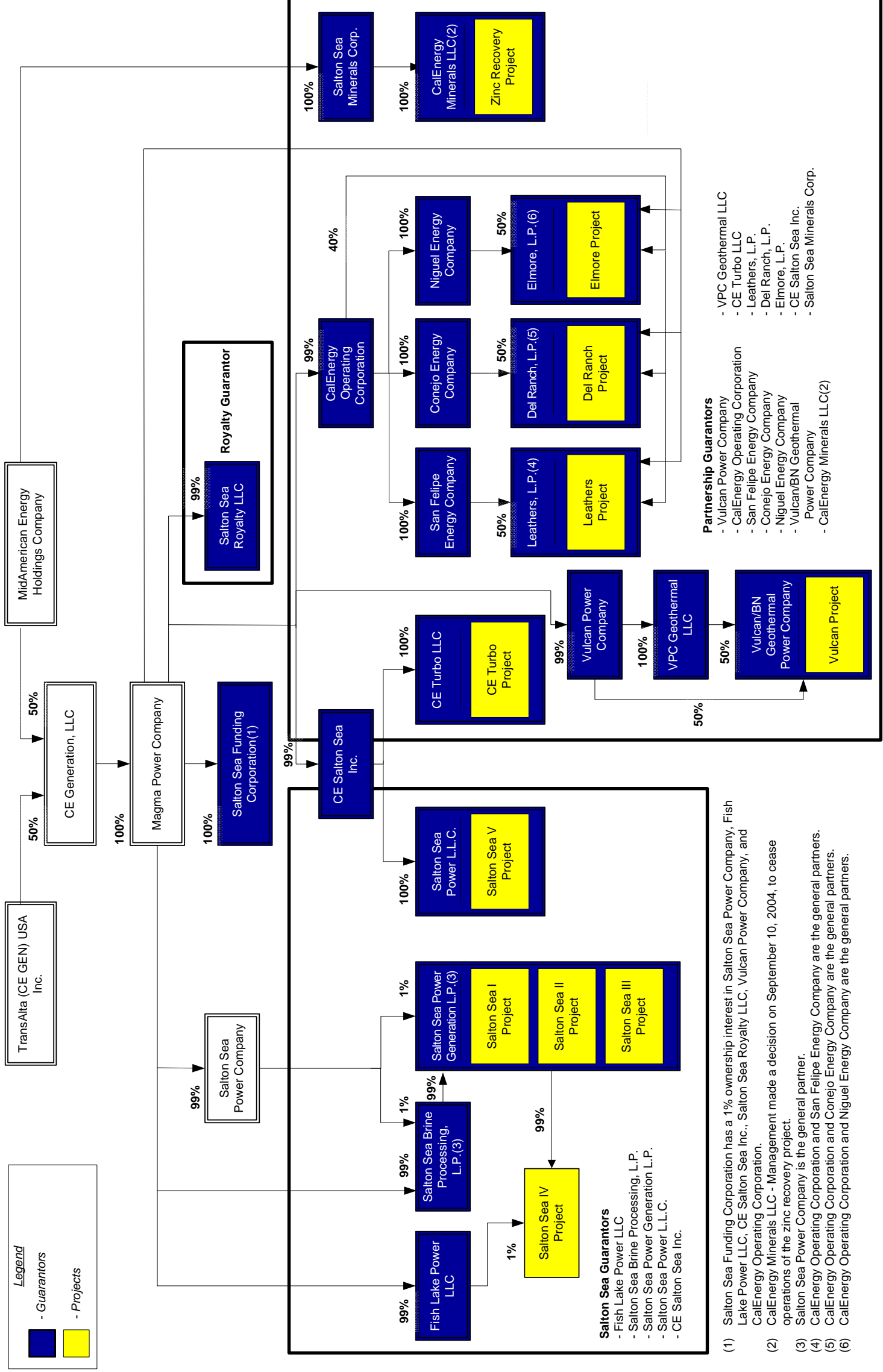
**SALTON SEA FUNDING CORPORATION AND GUARANTORS**  
**COMBINING STATEMENT OF CASH FLOWS**  
**For the Year Ended December 31, 2003**

EXHIBIT A (Continued)

(amounts in thousands)

	<u>Salton Sea Guarantors</u>	<u>Partnership Guarantors</u>	<u>Royalty Guarantor</u>	<u>Funding Corporation &amp; Eliminations</u>	<u>Combined</u>
<b>Cash flows from operating activities:</b>					
Income (loss) from continuing operations	\$ (43,348)	\$ (10,169)	\$ 7,965	\$ 139	\$ (45,413)
Adjustments to reconcile income (loss) from continuing operations to net cash flows from continuing operations:					
Depreciation and amortization	26,233	25,616	1,009	-	52,858
Deferred income taxes	369	3,487	-	-	3,856
Goodwill impairment	23,252	21,213	-	-	44,465
Amortization of deferred financing costs	1,102	272	42	-	1,416
Changes in other items:					
Trade accounts receivable	8,123	3,399	-	-	11,522
Inventories, prepaid expenses and other current assets	392	(450)	-	67	9
Accounts payable and accrued liabilities	(1,765)	7,361	(6)	-	5,590
Net cash flows from continuing operations	<u>14,358</u>	<u>50,729</u>	<u>9,010</u>	<u>206</u>	<u>74,303</u>
Net cash flows from discontinued operations	-	(24,518)	-	-	(24,518)
Net cash from operating activities	<u>14,358</u>	<u>26,211</u>	<u>9,010</u>	<u>206</u>	<u>49,785</u>
<b>Cash flows from investing activities:</b>					
Capital expenditures, net of warranty settlement	(2,675)	(20,021)	-	-	(22,696)
Purchases of available-for-sale securities	-	-	-	(152,300)	(152,300)
Proceeds from sales of available-for-sale securities	-	-	-	163,450	163,450
Net cash flows from continuing operations	<u>(2,675)</u>	<u>(20,021)</u>	<u>-</u>	<u>11,150</u>	<u>(11,546)</u>
Net cash flows from discontinued operations	-	(7,852)	-	-	(7,852)
Net cash from investing activities	<u>(2,675)</u>	<u>(27,873)</u>	<u>-</u>	<u>11,150</u>	<u>(19,398)</u>
<b>Cash flows from financing activities:</b>					
Repayment of senior secured notes and bonds	(21,979)	(3,609)	(1,093)	-	(26,681)
(Increase) decrease in due from affiliates	10,296	(9,877)	(7,917)	(51,740)	(59,238)
Net cash flows from continuing operations	<u>(11,683)</u>	<u>(13,486)</u>	<u>(9,010)</u>	<u>(51,740)</u>	<u>(85,919)</u>
Net cash flows from discontinued operations	-	15,580	-	-	15,580
Net cash from financing activities	<u>(11,683)</u>	<u>2,094</u>	<u>(9,010)</u>	<u>(51,740)</u>	<u>(70,339)</u>
<b>Net change in cash and cash equivalents</b>	-	432	-	(40,384)	(39,952)
<b>Cash and cash equivalents at the beginning of period</b>	-	12	-	50,875	50,887
<b>Cash and cash equivalents at the end of period</b>	<u>\$ -</u>	<u>\$ 444</u>	<u>\$ -</u>	<u>\$ 10,491</u>	<u>\$ 10,935</u>

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



- Partnership Guarantors**
- Vulcan Power Company
  - CalEnergy Operating Corporation
  - San Felipe Energy Company
  - Conejo Energy Company
  - Niguel Energy Company
  - Vulcan/BN Geothermal Power Company
  - CalEnergy Minerals LLC(2)

- Royalty Guarantors**
- VPC Geothermal LLC
  - CE Turbo LLC
  - Leathers, L.P.
  - Del Ranch, L.P.
  - Elmore, L.P.
  - CE Salton Sea Inc.
  - Salton Sea Minerals Corp.

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

(1) Salton Sea Funding Corporation has a 1% ownership interest in Salton Sea Power Company, Fish Lake Power LLC, CE Salton Sea Inc., Salton Sea Royalty LLC, Vulcan Power Company, and CalEnergy Operating Corporation.  
 (2) CalEnergy Minerals LLC - Management made a decision on September 10, 2004, to cease operations of the zinc recovery project.  
 (3) Salton Sea Power Company is the general partner.  
 (4) CalEnergy Operating Corporation and San Felipe Energy Company are the general partners.  
 (5) CalEnergy Operating Corporation and Conejo Energy Company are the general partners.  
 (6) CalEnergy Operating Corporation and Niguel Energy Company are the general partners.

**Legend**

- Guarantors
- Projects

