Department of Water Resources
Electric Power Fund
Financial Statements

December 31, 2007

Department of Water Resources Electric Power Fund
Index

USING THIS REPORT

This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities and to identify any significant changes in financial position of the Department of Water Resources Electric Power Fund (the Fund), which is administered by the California Department of Water Resources (DWR). Readers are encouraged to consider the information presented in conjunction with the financial statements as a whole, which follows *Management's Discussion and Analysis*. This discussion and analysis and the financial statements do not relate to DWR's other governmental and proprietary funds.

The basic financial statements include three required statements, which provide different views of the Fund. They are: the statement of net assets, the statement of revenues, expenses and changes in net assets, and the statement of cash flows. These statements provide current and long-term information about the Fund and its activities. These financial statements report information using accounting methods similar (although not identical) to those used by private sector companies. The statement of net assets includes all assets and liabilities as of a specified date. The statement of revenues, expenses and changes in net assets presents all revenues, expenses, and changes in net assets for a specific period. The statement of cash flows reports cash receipts, disbursements and the net change in cash resulting from three principal types of activities: operating, financing and investing. In order for the basic financial statements to be complete, they must be accompanied by a complete set of footnotes. The notes to the financial statements provide disclosures which are required to conform with generally accepted accounting principles. The Fund is required to follow accounting standards promulgated by the Governmental Accounting Standards Board.

This report should be read in conjunction with the Fund's June 30, 2007 audited financial statements.

BACKGROUND

The Fund was established in January 2001 through legislation to assist mitigation of the effects of a statewide energy supply emergency. DWR has the authority to secure and retain title to power for resale to end use customers of the State's investor owned utilities (IOUs) under power supply contracts entered into prior to January 1, 2003. The scheduling, dispatch, and certain other administrative functions for the long-term contracts are performed by the IOUs. However, DWR retains the legal and financial responsibility for the contracts until such time as there is complete assignment of the contracts to the IOUs and release of DWR. DWR is entitled to recover revenue requirements for authorized activities, including but not limited to debt service, the costs of power purchases, other expenses and reserves.

STATEMENTS OF NET ASSETS

The Fund's assets, liabilities and net assets as of December 31, 2007 and June 30, 2007 are summarized as follows (in millions):

	December 31, 2007	June 30, 2007
Long-term restricted cash, equivalents and investments	$ 1,542	$ 1,542
Recoverable costs, net of current portion	6,152	6,503
Restricted cash and investments:		
Operating and priority contract accounts	1,241	1,167
Bond charge collection and bond charge payment accounts	837	549
Recoverable costs, current portion	562	610
Interest receivable	42	41
Other assets	82	91
Total assets	$ 10,458	$ 10,503
Net assets	$ -	$ -
Long-term debt, including current portion	9,986	9,995
Other current liabilities	472	508
Total capital and liabilities	$ 10,458	$ 10,503

Long-Term Restricted Cash and Investments

There is no change in the $612 million balance in the Operating Reserve Account at December 31, 2007 from June 30, 2007. The amount is determined in accordance with the bond indenture and is equal to twelve percent of projected annual operating expenses of the Fund for calendar year 2007 as forecast in the DWR 2007 revenue requirement determination. The balance of the Debt Service Reserve Account remains at $930 million, equal to the maximum annual debt service on the outstanding bonds, also in accordance with the bond indenture.

Recoverable Costs, Net of Current Portion

Long-term recoverable costs consist of costs that are recoverable through future billings. The $351 million net decrease in long-term recoverable costs during the six month period ended December 31, 2007 is a combination of 1) operating revenues exceeding operating expenses by $46 million, and 2) bond charge revenue exceeding interest expense by $305 million.

Restricted Cash and Investments

The Operating and Priority Contract Accounts increased by $74 million during the six month period ending December 31, 2007. The 2007 revenue requirement forecasted a $139 million decrease in the Operating and Priority Contracts for this six month period. The principal reason for the difference is lower than expected power costs. The balance in the Operating and Priority Contract Accounts at December 31, 2007 is $304 million higher than forecast in DWR's 2007 revenue requirement.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $288 million in the six month period ended December 31, 2007 in anticipation of the upcoming $470 million principal payment and the next semi-annual interest payment on outstanding bonds on May 1, 2008.

From the dates of issuance of the revenue bonds through December 31, 2007, the balances in each of the restricted cash and investments accounts met or exceeded balances required by the Bond Indenture.

Recoverable Costs, Current Portion

The current portion of recoverable costs reflects billings to IOU customers that have not yet been collected and amounts due for surplus sales of energy and gas. The current portion of recoverable costs at December 31, 2007 is $48 million lower than at June 30, 2007. This decrease is primarily attributable to lower volumes of power sold to IOU customers in the two months prior to December 31, 2007 than in the two months prior to June 30, 2007. Lower surplus gas and energy volumes and lower prices received per unit of sales also contributed to the decline.

Other Assets

DWR purchases natural gas as fuel for the production of power under the terms of certain power purchase contracts and maintains a brokerage account with a national brokerage firm in order to hedge natural gas costs. Assets in this account are classified as other assets on the Statements of Net Assets.

Other assets decreased by $9 million in the six months ended December 31, 2007 to $82 million. Natural gas prices were slightly lower with stable markets reflecting no weather related events. At December 31, 2007, other assets consisted of money market obligations, US Treasury bills, and government bonds valued at $42 million and financial options valued at $40 million.

Long-Term Debt

The $9 million decrease in long-term debt for the six month period ended December 31, 2007 is attributable to the net amortization of bond premium and deferred loss on the advance bond refunding.

Other Current Liabilities

Accounts payable reflect one month's accrual for power and fuel purchases. At December 31, 2007 accounts payable are $31 million lower than at June 30, 2007 as prices of natural gas were lower while volumes of contract energy were substantially the same.

The $5 million decrease in accrued interest payable is the result of lower interest rate environment, decreasing the variable rates incurred by the Fund.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Fund's activities for the three and six months ended December 31, 2007 and 2006 are summarized as follows (in millions):

	Three months ended December 31		Six months ended December 31	
	2007	**2006**	**2007**	**2006**
Revenues:				
Power charges	$ 1,083	$ 1,154	$ 2,256	$ 2,414
Surplus sales	107	75	214	192
Bond charges	204	206	425	439
Interest income	44	34	88	72
Total revenues	1,438	1,469	2,983	3,117
Expenses:				
Power purchases	1,114	1,193	2,419	2,523
Energy settlements	-	(14)	(9)	(14)
Interest expense	107	106	208	208
Other expenses	9	8	14	15
Recovery of recoverable costs	208	176	351	385
Total expenses	1,438	1,469	2,983	3,117
Net income	-	-	-	-
Net assets, beginning of the period	-	-	-	-
Net assets, end of period	$ -	$ -	$ -	$ -

Power Charges

Power charges decreased by $158 million in the six months ended December 31, 2007 compared to the same six month period in 2006. Although the volume of power sold was 2% higher in 2007, the average remittance rate for the six month period in 2007, which is based on DWR's 2007 revenue requirement, is 7% lower than in the same period in 2006. The 2007 remittance rate is lower as a result of 1) anticipated lower fuel costs, and 2) the ability of DWR to reduce remittance rates in 2007 to purposefully reduce cash while maintaining required minimum balances in the Operating, Priority Contract, and Operating Reserve Accounts in excess of bond indenture requirements.

Surplus Sales

Surplus sales of energy and natural gas in the six month period ended December 31, 2007 are $22 million higher than in the same period in 2006. The dollar value of sales of excess natural gas in the six months ended December 31, 2007 was higher than in the same period in the prior year, reflecting higher market prices, while the volume sold was substantially the same. Surplus energy volumes were slightly lower during the six month period ended December 31, 2007 compared to the same period in 2006, offsetting a slightly higher rate per megawatt hour received on sales.

Bond Charges

Bond charges for the six months ended December 31, 2007 are $14 million lower than the same period in 2006, and are adequate to meet all debt service requirements and maintain bond indenture required account balances in the Bond Charge Collection, Bond Charge Payment, and Debt Service Reserve Accounts.

Interest Income

Interest income for the six months ended December 31, 2007 is $16 million higher than the interest income for the same period in 2006 and is attributable to higher balances earning interest and slightly higher rates received on investments in the State of California Investment Pooled Money Investment Account-Surplus Money Investment Fund.

Power Purchases

Power costs are $104 million lower in the six months ended December 31, 2007 than in the same period in 2006. The lower costs are primarily due to a decrease in hedging costs and amounts needed to meet margin calls in the natural gas hedging accounts during the 2007 period. Costs in the same period in 2006 were affected by the extraordinary decline in prices of natural gas from the prevailing levels that were hedged during the hurricane season of 2005. The volume of power purchased in 2007 was 3% higher than in 2006 and partially offset the lower costs.

Interest Expense

Interest expense in the six months ended December 31, 2007 is comparable to the amounts paid in the same period in 2006. Lower outstanding debt and amortization of premium and deferred loss on the sale of bonds were offset by arbitrage rebate interest paid to the Internal Revenue Service for excess interest earned on reserve balances above allowable amounts.

Other Expenses

Other expenses are substantially the same in the six months ended December 31, 2007 and 2006, respectively

Recovery (Deferral) of Recoverable Costs

The individual components of the recovery (deferral) of recoverable costs are as follows for the three and six months ended December 31, 2007 and 2006 (in millions):

	Three months ended December 31		Six months ended December 31	
	2007	**2006**	**2007**	**2006**
Operations	$ 67	$ 42	$ 46	$ 82
Debt service and related costs	141	134	305	303
	$ 208	$ 176	$ 351	$ 385

Operations
There was a recovery of $46 million for the six months ended December 31, 2007 reflecting lower than expected energy costs offsetting DWR's planned decrease in 2007 power charge remittance rates to purposefully lower cash balances while staying within bond indenture requirements.

Debt Service and Related Costs
The recovery of debt service and related costs are similar for the six months ended December 31, 2007 and 2006 and is comprised solely of the difference between bond charges and interest income less interest expense.

Department of Water Resources Electric Power Fund
Statements of Net Assets
December 31, 2007 and June 30, 2007(in millions)

	December 31, 2007	June 30, 2007
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 612	$ 612
Debt Service Reserve Account	930	930
Recoverable costs, net of current portion	6,152	6,503
Total long-term assets	7,694	8,045
Current assets:		
Restricted cash and investments:		
Operating and Priority Contract Accounts	1,241	1,167
Bond Charge Collection and Bond Charge Payment Accounts	837	549
Recoverable costs, current portion	562	610
Interest receivable	42	41
Other assets	82	91
Total current assets	2,764	2,458
Total assets	$ 10,458	$ 10,503
Capitalization and Liabilities		
Capitalization:		
Net assets	$ -	$ -
Long-term debt:		
Revenue bonds	9,501	9,508
Total capitalization	9,501	9,508
Current liabilities:		
Current portion of long-term debt	485	487
Accounts payable	422	453
Accrued interest payable	50	55
Total current liabilities	957	995
Commitments and contingencies (Note 5)		
Total capitalization and liabilities	$ 10,458	$ 10,503

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

Department of Water Resources Electric Power Fund
Statements of Revenues, Expenses and Changes in Net Assets
For the three and six months ended December 31, 2007 and 2006 (in millions)

	Three months ended December 31		Six months ended December 31	
	2007	**2006**	**2007**	**2006**
Operating revenues:				
Power charges	$ 1,083	$ 1,154	$ 2,256	$ 2,414
Surplus sales	107	75	214	192
Total operating revenues	1,190	1,229	2,470	2,606
Operating expenses:				
Power purchases	1,114	1,193	2,419	2,523
Energy settlements	-	(14)	(9)	(14)
Administrative expenses	9	8	14	15
Recovery of recoverable operating costs	67	42	46	82
Total operating expenses	1,190	1,229	2,470	2,606
Income from operations	-	-	-	-
Bond charges	204	206	425	439
Interest income	44	34	88	72
Interest expense	(107)	(106)	(208)	(208)
Recovery of recoverable debt service and related costs	(141)	(134)	(305)	(303)
Net income	-	-	-	-
Net assets, beginning of period	-	-	-	-
Net assets, end of period	$ -	$ -	$ -	$ -

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

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the six months ended December 31, 2007 and 2006 (in millions)

	2007	2006
Cash flows from operating income:		
Receipts:		
Power charges	$ 2,257	$ 2,371
Surplus sales	225	206
Energy settlements	9	14
Payments for power purchases and other expenses	(2,456)	(2,552)
Net cash provided by operating activities	35	39
Cash flows from non-capital financing activities:		
Receipt of bond charges	461	465
Interest payments	(222)	(222)
Net cash provided by non-capital financing activities	239	243
Cash flows from investing activities:		
Interest received	88	73
Net cash provided by investing activities	88	73
Net increase in cash and equivalents	362	355
Restricted cash and equivalents, beginning of period	2,658	2,365
Restricted cash and equivalents, end of period	$ 3,020	$ 2,720
Restricted cash and equivalents included in:		
Operating Reserve Account	$ 612	$ 591
Debt Service Reserve Account (a component of the total of $930 each at December 31, 2007 and 2006)	330	330
Operating and Priority Contract Accounts	1,241	1,020
Bond Charge Collection and Bond Charge Payment Accounts	837	779
Restricted cash and equivalents, end of period	$ 3,020	$ 2,720
Reconciliation of operating income to net cash provided by operating activities:		
Income from operations	$ -	$ -
Changes in net assets and liabilities to reconcile operating income to cash net provided in operations:		
Recoverable costs	66	47
Accounts payable	(31)	(8)
Total adjustments	35	39
Net cash provided by operating activities	$ 35	$ 39

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

1. Reporting Entity

In January 2001, the Governor of California issued an emergency proclamation directing the Department of Water Resources (DWR) to enter into contracts and arrangements for the purchase and sale of electric power to assist in mitigating the effect of a statewide energy supply emergency.

The Department of Water Resources Electric Power Fund (a component unit of the State of California) (the Fund), administered by DWR, was established in January 2001 through legislation adding Division 27 to the California Water Code.

In January 2001, DWR began selling electricity to approximately ten million investor owned utility (IOU) retail customers. DWR currently purchases power from wholesale suppliers under contracts entered into prior to January 1, 2003 and delivers the power to the customers through the transmission and distribution systems of the IOUs. Payments from the customers are collected for DWR by the IOUs pursuant to servicing arrangements approved and/or ordered by the California Public Utilities Commission.

Basis of Presentation
The Fund is accounted for as an enterprise fund and is financed and operated in a manner similar to that of a private business enterprise. The Fund uses the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. As allowed by governmental accounting standards, the Fund has elected not to apply statements and related interpretations issued by the Financial Accounting Standards Board after November 30, 1989. The Fund is accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenses.

The financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the business-type activities and major funds of the State of California that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position of the State of California and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

2. Restricted Cash and Investments

The State of California has a deposit policy for custodial credit risk. As of December 31, 2007, $20 million of the Fund's cash balances were uninsured and uncollateralized.

As of December 31, 2007, the Fund had the following investments (in millions):

Investment	Maturity	Amount
State of California Pooled Money Investment Account - Surplus Money Investment Fund	6.8 months average	$ 2,975
Cash		45
		3,020
Guaranteed investment contracts	May 1, 2022	500
Forward purchase agreement	May 1, 2008	100
		$ 3,620

The Fund's investments in the guaranteed investment contracts and forward purchase agreement are rated as follows, by Standard & Poor's (S&P) Moody's and Fitch Ratings (Fitch), respectively, at December 31, 2007 (in millions):

	Amount	S&P	Moody's	Fitch
GIC Providers				
FSA	$ 100	AAA	Aaa	AAA
XL Capital[1]	150	AAA	Aaa	AAA
Royal Bank of Canada	100	AA-	Aaa	AA
Sun America	150	AA+	Aa2	AA+
	$ 500			
FPA Provider				
Merrill Lynch: FHLMC Discounted Notes	$ 100	AAA	Aaa	AAA

[1] On February 15, 2008, this GIC was terminated because of ratings downgrades after December 31, 2007, and the funds were invested in the Surplus Money Investment Fund.

3. Long-Term Debt

The following activity occurred in the long-term debt accounts during the six months ended December 31, 2007 (in millions):

	Revenue Bonds	Unamor-tized Premium	Deferred Loss on Defeasance	Total Revenue Bonds
Balance, June 30, 2007	$ 10,054	$ 137	(196)	$ 9,995
Amortization		(16)	7	(9)
Less current portion	(470)	(30)	15	(485)
Balance, December 31, 2007	$ 9,584	$ 91	$ (174)	$ 9,501

The tax exempt revenue bonds consist of the following at December 31, 2007 (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding
A	3.1-6.0%	2022	2012	$ 3,274
B	Variable	2020	Callable	1,000
C, D, F	Variable	2022	Callable	3,992
G	Variable	2018	Callable	1,788
				10,054
Plus unamortized bond premium				121
Less deferred loss on defeasance				(189)
Less current maturities				(485)
				$ 9,501

The interest rates for the variable debt for the six months ended December 31, 2007, ranged from 2.50% to 4.05%.

Future payment requirements on the revenue bonds are as follows at December 31, 2007 (in millions):

Fiscal Year	Principal	Interest [1]	Total
2008	$ 470	$ 198	$ 668
2009	493	374	867
2010	518	351	869
2011	545	327	872
2012	573	302	875
2013-2017	3,330	1,079	4,409
2018-2022	4,124	412	4,536
	$ 10,054	$ 3,043	$ 13,097

[1] Variable portion of interest cost calculated using the December 31, 2007 Bond Market Association Municipal Swap index (BMA).

4. Interest Rate Swaps

The terms, fair values, and credit ratings of counterparties for the various swap agreements at December 31, 2007 are summarized in the following table (in millions):

Outstanding Notional Amount	Fixed Rate Paid by Fund	Variable Rate [1] Received by Fund	Fair Value	Swap Termination Date	Counterparty Credit Rating S&P	Moody's	Fitch
$ 94	2.914%	67% of LIBOR	$ (1)	May 1, 2011	AAA	Aaa	AAA
234	3.024%	67% of LIBOR	(3)	May 1, 2012	AAA	Aaa	AAA
190	3.405%	BMA	(3)	May 1, 2013	AA-	Aa2	AA-
95	3.405%	BMA	(2)	May 1, 2013	AA-	Aa3	AA-
28	3.405%	BMA	-	May 1, 2013	A+	A1	A+
194	3.204%	67% of LIBOR	(4)	May 1, 2014	AA	Aa1	AA
308	3.184%	66.5% of LIBOR	(4)	May 1, 2015	A+	Aa3	AA-
174	3.280%	67% of LIBOR	(3)	May 1, 2015	AAA	Aaa	AAA
202	3.342%	67% of LIBOR	(4)	May 1, 2016	AA+	Aa1	AA
485	3.228%	66.5% of LIBOR	(7)	May 1, 2016	AA+	Aa1	AA
202	3.389%	67% of LIBOR	(5)	May 1, 2017	AA-	Aa3	AA-
480	3.282%	66.5% of LIBOR	(8)	May 1, 2017	AA-	Aa3	AA-
514	3.331%	66.5% of LIBOR	(11)	May 1, 2018	AA	Aa1	AA-
306	3.256%	64% of LIBOR	(7)	May 1, 2020	AA	Aa1	AA-
453	3.325%	64% of LIBOR	(11)	May 1, 2022	AA-	Aaa	AA
$ 3,960			$ (73)				

[1] One month U.S. Dollar London Interbank Offered Rate or Bond Market Association Municipal Swap Index

The notional amounts of the swaps match the principal amounts of the associated debt. The swap agreements contain scheduled reductions in notional amounts that follow scheduled amortization of the associated debt.

As of December 31, 2007, the variable rates on DWR's hedged bonds ranged from 2.50% to 4.05%, while 64%, 66.5% and 67% of LIBOR received on a portion of the swaps was equal to 3.34%, 3.47%, and 3.50% respectively and BMA received on a portion of the swaps was 3.42%.

Basis Risk: The Fund is exposed to basis risk on the swaps that have payments calculated on the basis of a percentage of LIBOR (a taxable rate index). The terms, fair values, and credit ratings of the counterparties for the basis swaps at December 31, 2007 are summarized in the following table (in millions):

Outstanding Notional Amount	Variable Rate [1] Paid by Fund	Variable Rate [2] Received by Fund	Fair Value	Swap Termination Date	Counterparty Credit Rating S&P	Moody's	Fitch
$ 234	67% of LIBOR	62.83% of CMS	3	May 1, 2012	AA+	Aa1	AA
194	67% of LIBOR	62.70% of CMS	3	May 1, 2014	AA	Aa1	AA-
174	67% of LIBOR	62.60% of CMS	3	May 1, 2015	AA-	Aa2	AA-
202	67% of LIBOR	62.80% of CMS	3	May 1, 2016	AA+	Aa1	AA
202	67% of LIBOR	62.66% of CMS	3	May 1, 2017	AA-	Aa2	AA-
$ 1,006			$ 15				

1 One month U.S. Dollar London Interbank Offered Rate

2 Five year Constant Maturity Swap

As of December 31, 2007, 67% of LIBOR paid on the basis swaps was equal to 3.50% while the variable rates received based on the 5 year CMS Index varied from 2.64 to 3.08%.

Fair Value: The reported fair values in the tables above were determined based on quoted market prices for similar financial instruments.

Credit Risk: As of December 31, 2007, the Fund was exposed to $3 million of credit risk because one counterparty had a net positive value in regards to all swaps with that entity. That counterparty has a credit rating of AA-/Aa2/AA- and the swaps total 11% of outstanding notional amounts. All swap counterparties have investment grade credit ratings from the three major credit rating agencies shown in the tables

Termination Risk: DWR's swap agreements do not contain any out-of-the-ordinary termination provisions that would expose it to significant termination risk.

Rollover Risk: Since the swap agreements have termination dates and notional amounts that are tied to equivalent maturity dates and principal amounts of amortizing debt, there is no rollover risk associated with the swap agreements, other than in the event of a termination.

Swap Payments and Associated Debt: As rates vary, variable-rate bond interest payments and net swap interest payments will vary. As of December 31, 2007, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same, for their term were as follows (in millions):

Fiscal Year	Variable Rate Bonds Principal	Variable Rate Bonds Interest	Interest Rate Swaps, Net	Total
2008	$ 21	$ 68	$ 1	$ 90
2009	127	134	1	262
2010	80	130	1	211
2011	241	126	2	369
2012	258	118	2	378
2013-2017	1,959	466	2	2,427
2018-2022	1,274	109	(2)	1,381
	$ 3,960	$ 1,151	$ 7	$ 5,118

5. Commitments and Contingencies

Litigation and Regulatory Proceedings

Certain pending legal and administrative proceedings involving DWR or affecting DWR's Power Supply Program are summarized below.

California Refund Proceedings: During 2001 and 2002, DWR purchased power in bilateral transactions (both short term and long term), sold power to the California Independent System Operator (CAISO), paid for power purchased by the CAISO and purchased power from the CAISO for sale to customers of the IOUs. In July 2001, the Federal Energy Regulatory Commission (FERC) initiated an administrative proceeding to calculate refunds for inflated prices in the CAISO and California Power Exchange (PX) markets during 2000 and 2001. FERC ruled that DWR would not be entitled in that proceeding to approximately $3.5 billion in refunds associated with DWR's approximately $5 billion of short term purchases because DWR made those purchases bilaterally, not in the PX or CAISO markets. The Ninth Circuit Court of Appeals affirmed FERC, but left open the possibility of refunds on DWR's bilateral purchases in other FERC proceedings. In contrast, FERC ruled that DWR is entitled to refunds on purchases made by the CAISO where DWR actually paid the bill.

Of DWR's $5 billion in short term bilateral purchases, $2.9 billion was imbalance energy which DWR sold to the CAISO at DWR's cost in order to meet the CAISO's emergency needs during 2001. DWR is treated in the FERC refund proceeding as a seller of that energy to CAISO, and in May 2004, FERC issued an order requiring DWR to pay refunds on the sales to the CAISO. However, because DWR would likely be the primary recipient of any refunds on energy it sold to the CAISO, DWR's potential net liability associated with its sales to the CAISO would be substantially reduced. Settlements executed to date with various sellers have reduced that potential liability even further.

Under FERC's orders, therefore, DWR both owes refunds (on the energy it sold to the CAISO) and is entitled to refunds (on the energy that the CAISO purchased but DWR paid for); the effect of offsetting the two is likely to be that DWR would receive refunds.

As to refunds owed, FERC has ruled that to the extent DWR could demonstrate that payment of refunds would result in DWR's costs exceeding its revenues remaining after payment of refunds, DWR could request FERC to reduce the refunds. DWR made a cost recovery filing that DWR believes demonstrates that its costs related to sales to the CAISO exceeded its revenues, a demonstration that, if approved by FERC, would eliminate any refund amount DWR might otherwise be required to pay. In January 2006, FERC deferred action on DWR's cost filing on the basis that DWR, as described above, likely will be a net refund recipient, and net refund recipients, according to FERC, cannot make cost filings. Certain California parties have sought rehearing of that order.

In addition, in September 2005, the Ninth Circuit Court of Appeals ruled that FERC could not require governmental entities such as DWR to pay refunds.

Accordingly, DWR likely will be a net refund recipient in the FERC proceedings. Pending litigation could increase or decrease the level of the refunds DWR would be entitled to receive. DWR does not expect that FERC will order it to pay more in refunds than it receives on a marketwide basis.

Block Forward Contracts: In February 2001, the State commandeered block forward contracts between the PX and six suppliers. DWR took delivery of and paid a total of $350 million for energy under the contracts. Certain market participants claimed over $1 billion from the State in actions that were coordinated before the Sacramento County Superior Court. Subsequently, all but one market participant dismissed their complaints. In February 2008, the Superior Court granted the State's motion for summary judgment against the remaining market participant.

Commitments

DWR has power purchase contracts that have remaining lives of up to seven years. Payments under these contracts approximated $2.4 billion and $2.5 billion for the six month periods ended December 31, 2007 and 2006 respectively.

In December 2007, a significant power purchase contract was amended and restructured. The effect of the restructured agreement is to decrease future fixed obligations by more than $1 billion through December 2009.

The remaining amounts of fixed obligations under all contracts as of December 31, 2007, are as follows (in millions):

Fiscal Year	Fixed Obligation
2008	$ 788
2009	1,720
2010	1,501
2011	1,070
2012	460
Thereafter	108
	$ 5,648

In addition to the fixed costs there are variable costs under several of the contracts. Management projects as of December 31, 2007 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $12 billion. The difference between the fixed costs and the expected total costs of the contracts are primarily due to the variable factors associated with dispatchable contracts and the cost of natural gas.

Six of the power purchase contracts do not qualify as normal purchases and normal sales under the provisions of Governmental Accounting Standards Board Technical Bulletin 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*, primarily resulting from either pricing terms that contain variables which are not clearly and closely related to the base energy price or the seller is not a generator of electricity. As a result, certain information regarding these power purchase contracts is required to be disclosed. The fair value of these six contracts at December 31, 2007 approximated $(170) million, using forward market prices discounted at prevailing LIBOR rates.

DWR also has entered into transactions to hedge the price of natural gas through bilateral arrangements. The fair value of the various transactions at December 31, 2007 approximated $33 million, using forward market prices. These transaction volumes vary in size from 2,500 to 25,000 mmBtu per day, and they expire at various times from February 2008 through December 2011.