Department of Water Resources
Electric Power Fund
Financial Statements

March 31, 2011

Department of Water Resources Electric Power Fund
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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 the year-end date. The statement of revenues, expenses and changes in net assets presents all of the current year's revenues, expenses, and changes in net assets. 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.

PURPOSE OF FUND

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 as agents for DWR. However, DWR retains the legal and financial responsibility for each contract for the life of the contract or until such time as there is complete assignment of the contract to an IOU and release of DWR. Most of the volume of power under contract expires by June 30, 2012 and the last of the contracts expires in 2015.

DWR is entitled to recover revenue requirements for authorized activities, including but not limited to debt service, the costs of power purchases, administrative expenses and reserves. Revenue requirements are determined at least annually and submitted to the California Public Utilities Commission (CPUC) for implementation. Under the terms of the rate agreement between the CPUC and DWR, the CPUC is required to set rates for the customers of the IOUs and "direct access" Electric Service Providers (ESPs) such that the Fund will always have monies to meet its revenue requirements.

This report should be read in conjunction with the Fund's June 30, 2010 audited financial statements.

STATEMENTS OF NET ASSETS

The Fund's assets, liabilities and net assets as of March 31, 2011 and June 30, 2010 are summarized as follows (in millions):

	March 31, 2011	June 30, 2010
Long-term restricted cash, equivalents and investments	$ 1,207	$ 1,490
Recoverable costs, net of current portion	4,610	4,881
Restricted cash and investments:		
Operating and priority contract accounts	1,365	1,257
Bond charge collection and bond charge payment accounts	1,047	630
Recoverable costs, current portion	165	339
Interest receivable	11	7
Derivative financial instruments	9	25
Deferral of derivative cash outflows	49	195
Other assets	89	92
Total assets	$ 8,552	$ 8,916
Long-term debt, including current portion	$ 8,355	$ 8,417
Derivative instruments	54	203
Deferral of derivative cash inflows	3	8
Other current liabilities	140	288
Total capital and liabilities	$ 8,552	$ 8,916
Net assets	$ -	$ -

ASSETS

Long-Term Restricted Cash and Investments

The $288 million in the Operating Reserve Account at March 31, 2011 is $261 million lower than the $549 million at June 30, 2010. The amount is determined in accordance with the bond indenture and is equal to the maximum one month priority contract cost amount under stress conditions for calendar year 2011 as forecast in the DWR 2011 revenue requirement determination. Priority contract costs are significantly lower due to the expiration of several of the power contracts. The balance of the Debt Service Reserve Account is $919 million, and was determined in accordance with bond indenture requirements, representing the maximum annual debt service over the life of the bonds. This is lower than the $941 million balance at June 30, 2010 as a result of the 2010 Series M bond refunding transaction.

Recoverable Costs, Net of Current Portion

Long-term recoverable costs consist of costs that are recoverable through future billings. The $270 million net decrease in long-term recoverable costs during the nine month period ended March 31, 2011 is the combination of 1) operating expenses exceeding operating revenues by $270 million, as power costs were higher due to the return of excess operating reserves to the utilities and 2) bond charge revenues exceeding interest expense by $540 million.

Restricted Cash and Investments

The Operating and Priority Contract Account balances increased by $108 million during the nine month period ended March 31, 2011. DWR received $234 million in settlement revenues during the period. This was partially offset by a planned return of cash reserves to ratepayers through lower power charges.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $417 million in the period ended March 31, 2011 in anticipation of the upcoming annual principal repayment and semi-annual interest payment on fixed rate bonds both scheduled for May 1, 2011.

From the dates of issuance of the revenue bonds through March 31, 2011, 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 of $165 million at March 31, 2011, is $174 million lower than at June 30, 2010.

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. DWR invests funds to be used to meet realized losses as they occur, provide collateral for current positions, and enable future hedging activities that require margin or immediate payment. Assets in this account are classified as other assets on the statements of net assets.

At March 31, 2011, other assets consisted of money market obligations, US Treasury bills, and government bonds valued at $89 million.

Derivative Financial Instruments

The Fund is party to natural gas hedging transactions that are considered to be derivatives under the provisions of GASB 53 and included on the statement of net assets for periods ended March 31, 2011 and June 30, 2010.

Derivative financial instrument assets decreased $16 million, and totaled $9 million and $25 million at March 31, 2011 and June 30, 2010, respectively. The lower fair value of the derivative financial instruments is due primarily to the declining notional amounts of natural gas hedges in the period.

Deferred outflows decreased by $146 million to $49 million at March 31, 2011 from $195 million at June 30, 2010. Derivative financial instrument liabilities were lower after the termination of all remaining interest rate swaps completed as part of the 2010 Series M bond refunding and the reduction in natural gas derivative contracts as they expire. .

LIABILITIES

Long-Term Debt

Long-term debt decreased to $8,355 million as of March 31, 2011 from $8,417 million at June 30, 2010. The decrease is a result of the 2010 Series M refunding transaction lowering bonds outstanding and is also partly attributable to the early redemption of $3 million of outstanding principal resulting from DWR restructuring the 2005 Series F & G defeasance escrow in September 2010. The restructuring allowed for a release of funds due to accumulating negative arbitrage amounts, which DWR utilized to redeem Series G and Series J refunding bonds.

Net amortization of bond premium and deferred loss on defeasance and the early redemption was $11 million in the nine month period ended March 31, 2011.

Derivative Instruments-Liabilities

The Fund is party to interest rate swap agreements and natural gas hedging positions that are considered to be derivatives under the provisions of GASB 53 and included on the statement of net assets for periods ended March 31, 2011 and June 30, 2010.

Derivative financial instrument liabilities decreased $149 million, and were valued at $54 million and $203 million at March 31, 2011 and June 30, 2010, respectively. The decline was due to termination of all remaining interest rate swap derivatives completed as part of the 2010 Series M bond refunding and the expiration of natural gas hedge derivatives during the period. The changes in fair value are highlighted in Note 5.

Deferred inflows decreased to $3 million at March 31, 2011 from $8 million at June 30, 2010, as there were fewer derivative financial instruments outstanding with a concomitant reduction in value.

Other Current Liabilities

Accounts payable reflect one month's accrual for power and fuel purchases, as payments are normally made on the 20th of the month following purchase. At March 31, 2011 accounts payable are $87 million lower than at June 30, 2010 as a decline in dispatches from contracted power plant facilities resulted in lower contract energy and natural gas costs.

There was no accrued interest payable at March 31, 2011, as the interest and principal payment was funded in anticipation of the scheduled for May 1, 2011 payment date.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Fund's activities for the three and nine months ended March 31, 2011 and 2010 are summarized as follows (in millions):

	Three months ended March31		Nine months ended March 31	
	2011	**2010**	**2011**	**2010**
Revenues:				
Power charges	$ 68	$ 558	$ 1,125	$ 2,423
Surplus sales	47	42	$ 90	89
Bond charges	217	217	671	654
Investment income from gas related derivatives	-	-	-	-
Interest income	8	9	23	70
Total revenues	340	826	1,909	3,236
Expenses:				
Power purchases	418	723	1,701	2,324
Energy settlements	-	(22)	(234)	(36)
Interest expense	(77)	69	154	246
Investment Expense	-	-	-	-
Administrative expenses	6	8	18	27
Recovery(deferral) of recoverable costs	(7)	48	270	675
Total expenses	340	826	1,909	3,236
Net increase in net assets	-	-	-	-
Net assets, beginning of period	-	-	-	-
Net assets, end of period	$ -	$ -	$ -	$ -

REVENUES

Power Charges

The cost of providing energy is recoverable primarily through power charges to IOU customers and certain customers of ESPs. Charges are determined by applying a CPUC adopted rate for each IOU service area to the megawatt hours of power delivered by DWR to each IOU's customers.

Power charges decreased by $1,298 million in the nine months ended March 31, 2011 compared to the same nine month period in 2010. The decrease is a result of a combination of lower volumes of power sales to end use customers after the expiration of several power contracts and lower remittance rates after the implementation of DWR's 2011 revenue requirement in January 2011.

Surplus Sales

Surplus sales of natural gas in the nine month period ended March 31, 2011 were $1 million higher than in the same period in 2010 as higher gas sales volumes were offset by lower sales prices during the 2011 period.

Bond Charges

Bond charges provide revenue for the payment of debt service on the revenue bonds and are determined by applying a CPUC adopted rate to the total megawatt hours of power delivered to all IOU customers and certain ESP customers.

Bond charges for the nine months ended March 31, 2011 are $17 million higher than the same period in 2010. The amount collected is 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 of $23 million for the nine months ended March 31, 2011 is $47 million lower than the same period in 2010. The decrease is as a result of a decline in interest earned on investments in the State of California Investment Pooled Money Investment Account-Surplus Investment Fund (SMIF) with lower cash balances outstanding over the period and the termination of interest rate swaps in November 2010.

EXPENSES

Power Purchases

Power costs are $623 million lower in the nine months ended March 31, 2011 than in the same period in 2010. The decrease in costs is primarily due to less contract power purchased as a result of the expiration of a number of large power purchase contracts since the end of 2010.

Energy Settlements

In the nine month period ended March 31, 2011, the Fund received than $234 million in energy settlements. $233 million was received from Sempra and about $1 million was received from various other small settlements.

Under the terms of the settlement agreed to by Sempra and various parties including DWR in April 2010, in exchange for a cash payment by Sempra of approximately $410 million and certain other considerations, Sempra and certain of its affiliates will exchange mutual releases with DWR, the CPUC, the State Attorney General, Southern California Edison and PG&E (the "Settling Parties") Except for a limited number of enumerated exceptions, the mutual releases cover all claims related to the long term power purchase agreement between DWR and Sempra, and all claims related to the short-term energy or ancillary services transactions in the western energy markets during 2000 and 2001.

In October 2010, the settlement was finalized and sent to FERC for approval, and was subsequently approved in December 2010. Funds were then allocated among the Settling Parties, and DWR received two fund disbursements from Sempra, $130 million to cover all claims related to the long term power purchase agreement between DWR and Sempra, and $103 million to cover all claims related to the short-term energy or ancillary services transactions in the western energy markets during 2000 and 2001.

Future revenues under a number of settlements with larger suppliers including Mirant Corporation, Reliant Energy and Duke Energy Corporation, are subject to contingencies outlined in the underlying settlement and allocation agreements and will not be recognized until if and when the contingencies are resolved.

Interest Expense

Interest expense in the nine months ended March 31, 2011 is $92 million lower than the amounts paid in the same period in 2010. The decrease was due to lower total bond and swap interest expenses offset by higher expenses associated with the issuance of the 2010 Series L and M bonds. Interest expenses for the three months ended March 31, 2011 reflect adjustments to the amortization for the 2010 Series L and M bonds.

Investment Expense

As a result of implementing GASB 53, the Fund realized investment income (expense) for the change in fair value of outstanding ineffective gas hedges, and any income (expense) related to expiration of ineffective gas hedges. Due to changes in fair value of gas related hedges, the Fund realized investment expense of $7 million, while realizing $7 million of investment income from expiring ineffective gas hedges, resulting in approximately zero net investment expense for the nine month period ended March 31, 2011.

Other Expenses

Other expenses in the nine months ended March 31, 2011 were $9 million lower than the same period in 2010, as a result of decreased legal expenditures for contract renegotiations and litigation services regarding the 2000-2001 California energy crisis and the effects of the continued State furlough program. Reduced headcount of employees and consultants also affected expenses as DWR's power supply responsibilities continue to diminish.

Recovery (Deferral) of Recoverable Costs

The individual components of the recovery (deferral) of recoverable costs are as follows for the nine months ended March 31, 2011 and 2010 (in millions):

	Three months ended March 31		Nine months ended March 31	
	2010	**2010**	**2011**	**2010**
Operations	$ (231)	$ (109)	$ (270)	$ 197
Debt service and related costs	778	157	540	478
	$ 547	$ 48	$ 270	$ 675

Operations
There was a reduction of recoverable costs of $(270) million for nine months ended March 31, 2011. This reduction reflects the return of operating reserves to the utilities and power costs that are lower as a result of the expiration of a number of the purchase power contracts.

Debt Service and Related Costs
The $540 million recovery of debt service and bond related costs is $62 million higher for the nine months ended March 31, 2011 compared to the same period in 2010 due to lower interest expenses. The recovery is comprised solely of the difference between bond charges and interest income less interest expense.

LIQUIDITY

With the Series M refunding transaction in October 2010, the Fund reduced the amount of outstanding variable rate bonds to $948 million, and lowered the amount of expiring credit enhancement capacity that needed to be renewed by December 1, 2010 to $605 million. On November 19, 2010 the Fund executed a remarketing of those bonds with replacement credit facilities, completing the renewal or replacement of all current outstanding facilities. After the remarketing, there are no facility expirations until fiscal year 2013.

Department of Water Resources Electric Power Fund
Statements of Net Assets
March 31, 2011 and June 30, 2010 (in millions)

	March 31, 2011	June 30, 2010
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 288	$ 549
Debt Service Reserve Account	919	941
Derivative financial instruments, net of current portion	1	6
Other non-current deferred charges	3	112
Recoverable costs, net of current portion	4,610	4,881
Total long-term assets	5,821	6,489
Current assets:		
Restricted cash and investments:		
Operating and Priority Contract Accounts	1,365	1,257
Bond Charge Collection and Bond Charge Payment Accounts	1,047	630
Recoverable costs, current portion	165	339
Interest receivable	11	7
Derivative financial instruments	9	19
Prepaid expenses	45	83
Other Assets	89	92
Total current assets	2,731	2,427
Total assets	$ 8,552	$ 8,916
Capitalization and Liabilities		
Capitalization:		
Net assets	$ -	$ -
Long-term debt	7,882	7,878
Non-Current liabilities:		
Derivative instruments	5	114
Deferral of derivative cash inflows	-	2
Total capitalization and non-current liabilities	7,887	7,994
Current liabilities:		
Current portion of long-term debt	473	539
Derivative financial instruments	49	89
Deferral of derivative cash inflows, current portion	3	6
Accounts payable and other current liabilities	140	227
Accrued interest payable	-	61
Total current liabilities	665	922
Commitments and contingencies (Note 7)		
Total capitalization and liabilities	$ 8,552	$ 8,916

Department of Water Resources Electric Power Fund
Statements of Revenues, Expenses and Changes in Net Assets
For the three and nine months ended March 31, 2011 and 2010 (in millions)

	Three months ended March 31		Nine months ended March 31	
	2011	**2010**	**2011**	**2010**
Operating revenues:				
Power charges	$ 68	$ 558	$ 1,125	$ 2,423
Surplus sales	$ 47	42	90	89
Total operating revenues	115	600	1,215	2,512
Operating expenses:				
Power purchases	418	723	1,701	2,324
Energy settlements	-	(22)	(234)	(36)
Administrative expenses	6	8	18	27
Deferral of recoverable operating costs	(309)	(109)	(270)	197
Total operating expenses	115	600	1,215	2,512
Expense from operations	-	-	-	-
Bond charges	217	217	671	654
Interest income	8	9	23	70
Interest expense	77	(69)	(154)	(246)
Investment income (expense) from gas			-	
related derivatives	-	-	-	-
Recovery of recoverable debt service				
and related costs	(302)	(157)	(540)	(478)
Net increase in net assets	-	-	-	-
Net assets, beginning of period	-	-	-	-
Net assets, end of period	$ -	$ -	$ -	$ -

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the nine months ended March 31, 2011 and 2010 (in millions)

Nine months ending March 31,	2011	2010
Cash flows from operating activities:		
Receipts:		
Power charges	$ 1,279	$ 1,928
Surplus sales	107	50
Energy settlements	248	14
Payments for power purchases and other expenses	(1,804)	(1,630)
Net cash (used in) provided by operating activities	(170)	362
Cash flows from non-capital financing activities:		
Receipt of bond charges	661	457
Bond Payments	(3)	-
Interest payments	(223)	-
Proceeds from revenue bond issuance	1,946	-
Defeasance of revenue bonds	(1,997)	(181)
Net cash provided by non-capital financing activities	384	276
Cash flows from investing activities:		
Interest received on investments	19	66
Income received from derivative investments	8	-
Net cash provided by investing activities	27	66
Net increase in cash and equivalents	241	704
Restricted cash and equivalents, beginning of period	3,077	2,786
Restricted cash and equivalents, end of period	$ 3,318	$ 3,490
Restricted cash and equivalents included in:		
Operating Reserve Account	$ 288	$ 543
Debt Service Reserve Account (a component of the total of $919 and $950 at December 31, 2010 and 2009, respectively)	619	650
Operating and Priority Contract Accounts	1,364	1,334
Bond Charge Collection and Bond Charge Payment Accounts	1,047	963
Restricted cash and equivalents, end of year	$ 3,318	$ 3,490
Reconciliation of operating income to net cash (used in) provided by operating activities:		
Income from operations	$ -	$ -
Adjustments to reconcile operating income to net cash (used in) provided by operating activities:		
Recovery of recoverable operating costs	39	306
Changes in net assets and liabilities to reconcile operating income to net cash (used in) provided by operations:		
Recoverable costs	(119)	66
Other assets	(3)	-
Accounts payable	(87)	(10)
Net change in operating assets & liabilities:	(209)	56
Net cash (used in) provided by operating activities	$ (170)	$ 362

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 (the Code).

DWR purchases power from wholesale suppliers under contracts entered into prior to January 1, 2003 for resale to ten million customers of Pacific Gas & Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company (collectively referred to as the investor owned utilities or IOUs). The Code prohibits DWR from entering into new power purchase agreements, but allows DWR to enter into gas purchase contracts to provide fuel for power generation.

DWR power is delivered to the customers through the transmission and distribution systems of the IOUs and 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 (the CPUC).

Under the terms of a rate agreement between DWR and the CPUC, the CPUC implements DWR's determination of its revenue requirements by establishing customer rates that meet DWR's revenue needs to assure the payment of debt service, power purchases, administrative expenses and changes in reserves.

2. Summary of Significant Accounting Policies

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 as of March 31, 2011 and 2010, and the changes in its financial position and its cash flows, where applicable, for the periods then ended in conformity with accounting principles generally accepted in the United States of America.

Revenues and Recoverable Costs

DWR is required to at least annually establish a revenue requirement determination to recover all Fund costs, including debt service. The revenue requirement determination is submitted to the California Public Utilities Commission which then sets customer remittance rates. The Fund's financial statements are prepared in accordance with SFAS No. 71, "*Accounting for the Effects of Certain Types of Regulation*", which requires that the effects of the revenue requirement process be recorded in the financial statements. Accordingly, all expenses and credits, normally reflected in the change in net assets as incurred, are recognized when recovered from IOU customers. Costs that are recoverable through future billings are recorded as long-term assets.

Amounts that have been earned but not collected by DWR are recorded as the current portion of recoverable costs.

Customer charges are separated into two primary components, power charges and bond charges. Power charge revenues recover the cost of power purchases, other expenses and operating reserves and are recognized when energy provided by DWR is delivered to the IOU customers. Certain customers of “direct access” Electric Service Providers (ESPs) are assessed a “cost responsibility surcharge” that is used by DWR for the same purposes as power charge revenues. Bond charge revenues recover debt service, debt service reserves and other bond related costs and are recognized when energy provided by either DWR or the IOU, or an ESP, is delivered to IOU or ESP customers. Costs are recovered over the life of the bonds (through 2022) as determined by DWR’s revenue requirement process.

3. Restricted Cash and Investments

The State of California has a deposit policy for custodial credit risk. As of March 31, 2011, $7 million of the Fund’s cash balances were uninsured and uncollateralized.

As of March 31, 2011, the Fund had the following investments (in millions):

Investment	Maturity		Amount
State of California Pooled Money Investment Account - State Money Investment Fund	7.4 months average	$	3,297
Cash			21
			3,318
Guaranteed investment contracts	May 1, 2022		200
Forward purchase agreement	May 1, 2010		100
		$	3,618
Reconciliation to Statement of Net Assets:			
Operating Reserve Account		$	288
Debt Service Reserve Account			919
Operating and Priority Contract Accounts			1,364
Bond Charge Collection and Bond Charge Payment Accounts			1,047
		$	3,618

Interest Rate Risk: In accordance with its investment policy, the State of California manages its exposure to declines in fair values by limiting investments to the maximum maturities, as follows: U.S. Treasury securities, 5 years; federal agency securities, 5 years; bankers acceptances – domestic and foreign, 180 days; certificates of deposits, 5 years; commercial paper, 180 days; corporate bonds and notes, 5 years; repurchase agreements and reverse repurchase agreements, 1 year.

Credit Risk: The PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. These investments consist of U.S. government securities, securities of federally-sponsored agencies, U.S. corporate bonds, interest bearing time deposits in California banks, prime-rated commercial paper, bankers' acceptances, negotiable certificates of deposit, repurchase and reverse repurchase agreements. The PMIA policy limits the use of reverse repurchase agreements to limits of no more than 10% of the PMIA and commercial paper to limits not to exceed 30% of the PMIA. The PMIA does not invest in leveraged products or inverse floating rate securities. The PMIA is not rated.

The Fund's investments in the guaranteed investment contracts and forward purchase agreement are rated as follows, by Standard & Poor's (S&P) and Moody's, respectively, at March 31, 2011 (in millions):

	Amount	S&P	Moody's
GIC Providers			
FSA	$ 100	AA+	Aa3
Royal Bank of Canada	100	AA-	Aa1
	$ 200		
FPA Provider			
Merrill Lynch: FNMA Discounted Notes	$ 100	AAA	Aa3

Concentration of Credit Risk: The PMIA's concentration of credit risk is limited by spreading the investment mix over different investment types and issuers to minimize the impact any one industry, investment class, or institution can have on the PMIA portfolio.

Interest on deposits in the PMIA varies with the rate of return of the underlying portfolio and approximated 0.46% at March 31, 2011. Interest on the GICs is paid semi-annually at interest rates ranging from 5.3% to 5.5%. The FPA allows DWR to continuously reinvest funds in U.S. government or U.S. government agency securities through May 2022 to earn a minimum rate of return of 4.7%, as specified in the Reserve Fund Forward Purchase and Sale Agreement, dated May 1, 2004. The reinvested securities are structured to mature every six months.

4. Long-Term Debt

The following activity occurred in the long-term debt accounts during the nine months ended March 31, 2011 (in millions):

	Revenue Bonds	Unamortized Premium	Deferred Loss on Defeasance	Total Revenue Bonds
Balance, June 30, 2010	$ 8,395	$ 398	$ (376)	$ 8,417
Refunding				
Issuance of Debt	1,763	183	-	1,946
Defeasance of Debt	(1,868)	-	(129)	(1,997)
Amortization	(3)	(66)	58	(11)
Less current portion	(457)	(100)	84	(473)
Balance, March 31, 2011	$ 7,830	$ 415	$ (363)	$ 7,882

The tax exempt revenue bonds consist of the following at March 31, 2011 (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding 2010
A	Fixed (3.7-5.5%)	2013	2012	$ 777
B	Variable	2020	Callable	25
C	Variable	2022	Callable	923
F	Fixed (3.256-3.325%)	2022	Callable	348
G	Fixed (3.184-3.331%)	2018	Callable	173
H	Fixed (3.75-5.0%)	2022	2018	1,007
K	Fixed (4.0-5.0%)	2018	Non-callable	279
L	Fixed (2.0-5.0%)	2022	2020	2,992
M	Fixed (1.0-5.0%)	2020	Non-callable	1,763
				$ 8,287
Plus unamortized bond premium				515
Less deferred loss on defeasance				(447)
Less current maturities				(473)
				$ 7,882

Bond refunding transactions

Last fall, to address the upcoming expiration of letters of credit by December 1, 2010 and reduce the risk and dependency from credit support providers and interest rate swap counterparties, DWR current refunded $1,054 million of variable rate bonds and terminated the associated interest rate swaps as part of a Series 2010 M fixed rate refunding transaction in October 2010. As part of this refunding $5 million Series 2002 B bonds, $424 million Series 2002 C bonds, $409 Series 2005 G bonds, $217 million Series 2008 J bonds were refunded to fixed rate bonds. Additionally, as part of the Series M refunding transaction, DWR advance refunded $813 million of existing 2002 Series A fixed rate bonds, issuing fixed rate bonds with lower debt service cost to provide savings to ratepayers. In total the Fund issued $1,763 million Series M fixed rate bonds with coupons ranging from 1.0% and 5.0%. The bonds were sold with a premium of $183 million and the Fund incurred a net accounting loss of $129 million after adjusting for prior gains and losses from earlier refunding transactions extinguished as part of this transaction. The loss includes cost of issuance of $9 million and interest rate swap termination fees of $117 million. Such amounts will be amortized over the life of the Series M bonds.

The Fund incurred an economic gain (difference between the present values of the old and new debt service payments) of $25 million on the advance refunding of the 2002 Series 2002 A fixed rate bonds.

With the Series M refunding transaction the Fund reduced the amount of outstanding variable rate bonds to $948 million and lowered the amount of expiring credit enhancement capacity needing to be renewed by June 30, 2011 to $605 million. Subsequently, in November 2010, DWR successfully remarketed the $605 million variable rate bonds outstanding with expiring facilities, with replacement credit facilities and credit providers, all in weekly mode. The new facilities were signed with two year terms expiring December 1, 2012.

Bond redemption

During the nine month period, DWR completed an early redemption of $3 million of outstanding principal resulting from DWR restructuring the 2005 Series F & G defeasance escrow. The restructuring allowed for a release of funds due to accumulating negative arbitrage amounts, which DWR utilized to redeem $1.5 million Series G and $1.5 million Series J refunding bonds.

Key terms

Principal and interest payments are payable from bond charges. The Fund is subject to certain bond covenants, including establishing funding and expenditure requirements for several restricted cash and investment accounts. The bonds are limited special obligations of the Fund. Neither the principal nor any interest thereon constitutes a debt of the State of California.

The Series A bonds are callable May 1, 2012 through October 31, 2012 at a redemption rate of 101%, from November 1, 2012 through April 30, 2013 at a redemption rate of 100.5% and thereafter, at 100%. The Series H bonds are callable in 2018 at a redemption rate of 100%. The Series L bonds are callable in 2020 at a redemption rate of 100%; The Series M bonds are non-callable and have a final maturity of 2020. .

The Fund's variable rate bonds are all in weekly rate reset mode. The variable rate bonds have a final stated maturity of 2022, but are scheduled to be retired in sinking fund installments from 2011 to 2022. The interest rates for the variable debt for the quarter ended March 31, 2011 ranged from 0.07% to 0.65%.

Remarketing, credit support and related uncertainties

DWR variable rate bonds are remarketed by seven different broker-dealer remarketing agents, with credit enhancement provided by four banks to spread its risk exposure among many firms. Remarketing agents can experience problems finding investors for certain bonds, including those with credit enhancement from banks and insurers that have perceived credit risk, as well as risk specific to their own company that carries negative perception with investors. Failed remarketings can result in the credit enhancing bank's required purchase of the bonds, and they become "bank bonds". If this occurs, the Fund is required to pay a stated fixed interest rate quarterly until the bonds are successfully remarketed. If the agreements expire or are terminated, the Fund is required to begin paying principal in quarterly installments at least six months after termination. The liquidity facilities require repayment in nineteen or twenty seven equal quarterly installments depending on the provider.

Negative credit market impacts can increase borrowing costs on variable rate bonds that experience interest rate resets at higher rates and on occasion will cause the remarketing failure of bonds resulting in those bonds becoming bank bonds. The level of bank bonds can fluctuate daily as the bonds are successfully remarketed. At March 31, 2011, there were no outstanding bank bonds.

At March 31, 2011, $343 million of Series C bonds are credit enhanced by bond insurance for the timely payment of principal and interest. All insured bonds are enhanced by FSA bond insurance which was rated AA+/Aa3 by S&P and Moody's at March 31, 2011. Liquidity support for these variable rate bonds is provided by bank liquidity facilities. Any funds paid under the bond insurance facilities are immediately due and payable by the Fund. Bonds purchased under the initial liquidity facilities are required to be redeemed in equal quarterly installments over a five or seven year period beginning six months after the termination date of the liquidity facilities. There are no outstanding amounts due under liquidity facilities at March 31, 2011. The liquidity facilities backing the $343 million of Series C bonds and all $605 million other non insured Series B and C bonds expire in fiscal year 2013. The Fund pays fees of 0.70% per annum under all liquidity facilities.

Future payment requirements on the revenue bonds are as follows at March 31, 2011 (in millions):

Fiscal Year	Principal	Interest [1]	Total
2011	457	86	543
2012	556	322	878
2013	583	296	879
2014	611	269	880
2015	639	241	880
2016-2020	3,690	747	4,437
2121-2022	1,751	95	1,846
	$ 8,287	$ 2,056	$ 10,343

[1] Variable portion of interest cost calculated using the March 31, 2011 Securities Industry and Financial Markets Association Swap Index (SIFMA).

5. Derivative Financial Instrument

GASB 53 requires governments to record derivative instruments on the statement of net assets as either assets or liabilities depending on the underlying fair value of the derivative. The Fund is party to natural gas hedging positions and prior to October 2010 was party to interest rate swap agreements that are considered to be derivatives under the provisions of GASB 53 and included on the statements of net assets as of March 31 and June 30, 2010.

The Fund had entered into interest rate swap agreements with various counterparties to reduce variable interest rate risk. The interest rate swaps were all terminated as part of the Series 2010 M refunding transaction.

The fair values, classification and notional amounts outstanding for DWR's natural gas hedge derivatives and interest rate swaps accounted for as derivative financial instruments at March 31, 2011 and June 30, 2010 are summarized in the following table:

As of March 31, 2011

		Business-type activities		Value	Notional	
Effective hedges						
Assets						
	Current	Gas Swaps	$	2.7	9,015,000	MMBtu
	Long Term	Gas Swaps		0.2	412,500	MMBtu
			$	2.9		
Liabilities						
	Current	Gas Swaps	$	(45.7)	28,977,500	MMBtu
	Long Term	Gas Swaps		(3.0)	2,140,000	MMBtu
			$	(48.8)		
Investment hedges						
Assets						
	Current	Gas Swaps	$	1.9	11,337,500	MMBtu
	Current	Gas Options		4.9	54,902,500	MMBtu
	Long Term	Gas Swaps		0.2	307,500	MMBtu
	Long Term	Gas Options		0.8	2,650,000	MMBtu
			$	7.9		
Liabilities						
	Current	Gas Swaps	$	(2.9)	7,860,000	MMBtu
	Current	Gas Options		(0.1)	(3,060,000)	MMBtu
	Long Term	Gas Swaps		(2.2)	1,587,500	MMBtu
			$	(5.2)		

As of June 30, 2010

	Business-type activities		Value	Notional
Effective hedges				
Assets				
Current	Gas Swaps	$	6.1	9,075,000 MMBtu
Long Term	Gas Swaps		1.8	5,450,000 MMBtu
		$	7.9	
Liabilities				
Current	Gas Swaps	$	(83.3)	64,220,000 MMBtu
Long Term	Gas Swaps		(19.6)	12,900,000 MMBtu
Long Term	Interest Rate Swaps		(92.2)	$1,052,900,000
		$	(195.1)	
Investement hedges				
Assets				
Current	Gas Swaps	$	0.9	4,990,000 MMBtu
Current	Gas Options		12.4	128,704,999 MMBtu
Long Term	Gas Swaps		0.3	1,225,000 MMBtu
Long Term	Gas Options		3.9	10,930,000 MMBtu
		$	17.5	
Liabilities				
Current	Gas Swaps	$	(2.1)	5,712,500 MMBtu
Current	Gas Options		(3.4)	48,944,999 MMBtu
Long Term	Gas Swaps		(2.4)	3,162,500 MMBtu
		$	(7.9)	

Natural Gas Hedging Instruments

Commodity contracts

The Fund enters into forward gas futures and options contracts to hedge the cost of natural gas. Most of the Fund's forward gas futures are being treated as Normal Purchase Normal Sale (NPNS) contracts and are therefore not required to be recorded prior to settlement. Forward gas futures not qualifying as NPNS are recorded on the statements of net assets at fair value. Additionally, under GASB 53, all natural gas options are classified as derivatives. Prior to the adoption of GASB 53, these option contracts were recorded at fair value, but were previously reported as other assets. All natural gas options are treated as derivatives and are classified as investment derivatives since they do not meet GASB 53 hedging criteria.

For the Fund’s gas hedging contracts that are effective hedges, unrealized gains and losses are deferred on the statement of net assets as current assets or liabilities for contracts with less than 12 months remaining until expiration, or as long-term assets or liabilities for contracts with more than 12 months remaining until expiration. The deferred amount recorded on the statements of net assets reflects the deferred inflow or outflow associated with the derivative financial instruments. Such amounts, adjusted for subsequent changes in fair value, will be recognized in the statements of revenues, expenses and changes in net assets.

Changes in fair value of derivatives that are classified as investment derivatives are included as investment income (expense) on the statement of revenues, expenses and changes in net assets.

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

Credit Risk: The Fund's open natural gas hedge positions at March 31, 2011 are with nine different counterparties, all of which have credit ratings of at least A-/Baa1. At March 31, 2011, the Fund has credit risk exposure to five counterparties totaling $2 million, representing transactions with market values that are in the Fund's favor. There is no substantial credit exposure to the remaining four counterparties, as natural gas price trends have resulted in valuations in the counterparties' favor. The remaining gas hedge positions have been entered into through the Fund's brokerage accounts and the associated clearing accounts have collateral requirements that limit the Fund's counterparty credit risk.

Termination Risk: With regards to gas hedge agreements, the Fund or the counterparty may terminate an agreement if the other party fails to perform under the terms of the contract. In addition, the agreements allow either party to terminate in the event of a significant loss of creditworthiness by the other party. If a termination were to occur, the Fund or the counterparty would owe the other a payment equal to the fair value of the open positions.

Interest Rate Swaps

As part of the Series 2010 M refunding transaction in October 2010, DWR terminated all remaining interest rate swaps, paying $117 million in total termination payments, financing $94 million with bond proceeds and using $23 million of cash on hand. The amounts included accrued interest through the termination date and any negative fair market value changes. The interest rate swap derivative values were removed from the balance sheet and the losses incurred on termination is being deferred and amortized as part of the refunding transaction.

6. Commitments and Contingencies

Litigation and Regulatory Proceedings

Certain pending legal and administrative proceedings involving the Fund or affecting the Fund's power supply program are summarized below.

California Refund Proceedings: During 2001 and 2002, the Fund purchased power in bilateral transactions (both short term and long term), sold power to the 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 the Fund would not be entitled in that proceeding to approximately $3.5 billion in refunds associated with the Fund's approximately $5 billion of short term purchases because the Fund 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 the Fund's bilateral purchases in other FERC proceedings. In contrast, FERC ruled that the Fund is entitled to refunds on purchases made by the CAISO where the Fund actually paid the bill.

Of the Fund's $5 billion in short term bilateral purchases, $2.9 billion was imbalance energy which the Fund sold to the CAISO at the Fund's cost in order to meet the CAISO's emergency needs during 2001. The Fund is treated in the FERC refund proceeding as a seller of that energy to CAISO, and in May 2004, FERC issued an order requiring the Fund to pay refunds on the sales to the CAISO. However, because the Fund would likely be the primary recipient of any refunds on energy it sold to the CAISO, the Fund'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, the Fund both owes refunds (on the energy it sold to the CAISO) and is entitled to refunds (on the energy that the CAISO purchased but the Fund paid for); the effect of offsetting the two is likely to be that the Fund would receive refunds.

As to refunds owed, FERC has ruled that to the extent the Fund could demonstrate that payment of refunds would result in the Fund's costs exceeding its revenues remaining after payment of refunds, the Fund could request FERC to reduce the refunds. The Fund made a cost recovery filing that the Fund 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 the Fund might otherwise be required to pay. In January 2006, FERC deferred action on the Fund's cost filing on the basis that the Fund, 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 the Fund to pay refunds.

Accordingly, although subject to uncertainty, the Fund expects it likely will be a net refund recipient in the FERC proceedings. Pending litigation could increase or decrease the level of the refunds the Fund would be entitled to receive. The Fund does not expect that FERC will order it to pay more in refunds than it receives on a market-wide basis.

Direct Access Proceeding: On February 28, 2008, the CPUC approved a decision concluding that the suspension of direct access cannot be lifted at the present time because the Fund is still supplying power under the Act. However, the decision continued the proceeding to consider possible approaches to expediting the Fund's exit from its role of supplying power under the Act. On November 21, 2008, the CPUC adopted a plan with the goal of the early exit of the Fund from its role as supplier of power to retail electric customers. Under this plan, the Fund's power purchase contracts would be replaced by agreements between the IOUs and the Fund's power supplier counterparties that are not detrimental to ratepayers, through novation and/or negotiation.

Provisions in a majority of the remaining the Fund power purchase contracts would, if certain conditions are satisfied (including a minimum credit rating requirement for the IOU in some contracts), allow for the Fund to novate the contract to a qualifying IOU. The Fund's interest in and obligations under such a contract would be terminated upon such a novation. Four contracts currently lack such a provision, thus requiring negotiations with those counterparties before the Fund's interest in and obligations under those contracts could be terminated prior to their scheduled termination. No assurance can be given that agreement could be reached with any of the counterparties to those four contracts or as to the timing of any such agreement. As of March 31, 2011, power purchase contracts with Calpine and GWF had been novated and replacement agreements entered into, terminating DWR's obligations to those counterparties.

While the CPUC has expressed a goal of novating contracts, numerous conditions need to be satisfied in order to complete the process. As such, timing and extent of future novation is uncertain. In the event of contract novation, management will reassess the impact on existing and future revenue requirements and consider modifying power charges accordingly. Management does not believe there will be a significant impact to the Fund's financial position in the event of novations of contracts.

Senate Bill 695: On October 11, 2009, Senate Bill (SB) 695 was signed into law as an urgency statute. SB 695 allows individual retail nonresidential end-use customers to acquire electric service from other providers in each IOU service area, up to a maximum allowable limit. Except for this express authorization for increased direct access transactions under SB 695, the previously enacted suspension of direct access remains in effect. On March 15, 2010, the CPUC issued Decision 10-03-022 which authorizes increases in the maximum direct access load for each IOU service area, as specified in SB 695. The maximum load of allowable direct access volumes is established for each IOU as the maximum total kWh supplied by all other providers to distribution customers of that IOU during any sequential 12-month period between April 1, 1998 and the effective date of the section of the Public Utilities Code modified by SB 695, October 11, 2009.

Decision 10-03-022 phases in the additional load allowance over a four-year period beginning on April 11, 2010. The annual phase-in of the limits combined with the concurrent expiration of several long-term contracts should result in limited impacts to the Power Charges attributable to the increased limits. Regardless of the level of direct access participation within the IOU service areas, direct access customers will still be assessed Bond Charges and the Fund's revenue requirement will be recovered in the same manner as has been successfully implemented over the duration of the Power Supply Program.

Other Contingencies
The Fund is self-insured for most risks, including general liability and workers' compensation. Management believes the Fund's exposure to loss is immaterial and that any costs associated with such potential losses are recoverable from customers as part of DWR's revenue requirement.

Commitments
DWR has power purchase contracts that have remaining lives of up to four years. Payments under these and gas purchase contracts approximated $1.8 billion and $2.3 billion for the nine month periods ended March 31, 2011 and 2010, respectively.

The remaining amounts of fixed obligations under the contracts as of March 31, 2011, are as follows (in millions):

For the Year Ending June 30,	Fixed Obligation (in millions)
2011	283
2012	585
2013	53
2014	15
2015	4
Thereafter	1
	$ 941

In addition to the fixed costs there are variable costs under several of the contracts. Management projected as of March 31, 2011 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $1.4 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.

7. Energy Settlements

The Fund and other parties have entered into settlement agreements with various energy suppliers which resolve potential and alleged causes of action against suppliers for their part in alleged manipulation of natural gas and electricity commodity and transportation markets during the 2000 - 2001 California energy crisis, and also received settlements from other FERC actions.

In the nine month period ended March 31, 2011, the Fund received than $234 million in energy settlements. $233 million was received from Sempra and approximately $1 million was received from various other entities for settlements.

Under the terms of the settlement agreed to by Sempra and various parties including DWR in April 2010, in exchange for a cash payment by Sempra of approximately $410 million and certain other considerations, Sempra and certain of its affiliates will exchange mutual releases with DWR, the CPUC, the State Attorney General, Southern California Edison and PG&E (the "Settling Parties") Except for a limited number of enumerated exceptions, the mutual releases cover all claims related to the long term power purchase agreement between DWR and Sempra, and all claims related to the short-term energy or ancillary services transactions in the western energy markets during 2000 and 2001.

In October 2010, the settlement was finalized and sent to FERC for approval, and was subsequently approved in December 2010. Funds were then allocated among the Settling Parties, and DWR received two fund disbursements from Sempra, $130 million to cover all claims related to the long term power purchase agreement between DWR and Sempra, and $103 million to cover all claims related to the short-term energy or ancillary services transactions in the western energy markets during 2000 and 2001.

Under the terms of the proposed settlement DWR and Sempra will continue to perform their respective obligations under the power purchase agreement and the agreement costs will continue to be included in the Fund's revenue requirement.

Future revenues under the Mirant Corporation, Reliant Energy, and Duke Energy Corporation settlements are subject to contingencies outlined in the underlying settlement and allocation agreements and will not be recognized until if and when the contingencies are resolved

8. Related Party Transactions

The California State Teachers' Retirement System (STRS), which is part of the California state government, participates in the Fund's letters of credit with three financial institutions. The total commitment for eight letters of credit underlying the STRS' participation approximates $153 million and expires on November 19, 2012. There are no outstanding amounts on the letters of credit at March 31, 2011.