Department of Water Resources
Electric Power Fund
Financial Statements

For the years ended June 30, 2009 and 2008

Department of Water Resources Electric Power Fund
Index

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Report of Independent Auditors

The Director of the State of California
Department of Water Resources

In our opinion, the accompanying statements of net assets and the related statements of revenues, expenses and changes in net assets and of cash flows present fairly, in all material respects, the financial position of the Department of Water Resources Electric Power Fund (the Fund), a component unit of the State of California, at June 30, 2009 and 2008, and its changes in financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Fund's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2, the financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flows, 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 at June 30, 2009 and 2008, and the changes in its financial position and its cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis presented on pages 2 through 10 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

October 28, 2009

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 December 31, 2011 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.

STATEMENTS OF NET ASSETS

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

	2009	2008	2007
Long-term restricted cash, equivalents and investments	$ 1,493	$ 1,465	$ 1,542
Recoverable costs, net of current portion	5,691	5,934	6,503
Restricted cash and equivalents:			
Operating and priority contract accounts	964	1,227	1,167
Bond charge collection and bond charge payment accounts	629	619	549
Recoverable costs, current portion	468	511	610
Interest receivable	13	27	41
Other assets	72	261	91
Total assets	$ 9,330	$ 10,044	$ 10,503
Net assets	$ -	$ -	$ -
Long-term debt, including current portion	9,001	9,509	9,995
Other current liabilities	329	535	508
Total capital and liabilities	$ 9,330	$ 10,044	$ 10,503

Long-Term Restricted Cash, Equivalents and Investments

The $28 million increase in long-term restricted cash, equivalents and investments during fiscal 2009 is a combination of a $5 million decrease in the Operating Reserve Account and a $33 million increase in the Debt Service Reserve Account.

The Operating Reserve Account decreased by $5 million to $543 million as forecasted power costs in DWR's 2009 revenue requirement were similar to the prior year and no contracts expired or were renegotiated during the year. DWR was able to slightly reduce required reserves and maintain the balance at a level determined in accordance with the bond indenture, equal to the maximum one month priority contract cost amount under stress conditions. The Debt Service Reserve Account increased to $950 million due to increased debt service cost assumptions resulting from bond refunding transactions in 2008 and 2009, highlighted below in the Long-Term Debt section.

The $77 million decrease in long-term restricted cash and investments during fiscal 2008 is a combination of a $64 million decrease in the Operating Reserve Account and a $13 million decrease in the Debt Service Reserve Account. The Operating Reserve Account was decreased to $548 million and allowed DWR to maintain the balance at a level determined in accordance with the bond indenture, equal to the maximum one month priority contract cost amount under stress conditions. The Debt Service Reserve Account was decreased to $917 million due to lower interest rate assumptions as a result of refunding transactions in 2008.

Recoverable Costs, Net of Current Portion

Long-term recoverable costs consist of costs that are recoverable through future billings. The $243 million decrease during fiscal 2009 is due to 1) operating expenses exceeding operating revenues by $332 million, as a result of the planned under recovery of costs while maintaining minimum bond indenture requirements for cash balances, offset by 2) bond charges plus interest income exceeding interest expense by $575 million. The surplus of bond charge collections over interest costs is primarily a result of the Fund's rate design which includes funding for annual debt service, including principal payments.

The $570 million decrease during fiscal 2008 is due to 1) operating expenses exceeding operating revenues by $35 million, and 2) bond charges plus interest income exceeding interest expense by $605 million.

Restricted Cash, Equivalents and Investments

The Operating and Priority Contract Accounts decreased by $263 million in 2009 as DWR purposefully lowered cash balances though a planned under recovery of costs while maintaining minimum balances as required in the bond indenture. The $964 million balance in the Operating and Priority Contract Accounts at June 30, 2009 is $95 million higher than forecast in DWR's calendar 2009 revenue requirement determination. The balance as of June 30, 2009 was higher than planned primarily due to lower than expected costs in the last six months of the fiscal year as actual natural gas prices were lower than forecast in the 2009 revenue requirement, and DWR received $30 million in unplanned energy settlements.

The Operating and Priority Contract Accounts increased by $60 million in 2008 due to lower than expected costs in the first six months of the fiscal year, $32 million in unplanned energy settlements and collection of $20 million in collateral funds collected from a counterparty to collateralize DWR's natural gas hedge investments. The $1,227 million balance in the Operating and Priority Contract Accounts at June 30, 2008 is $71 million higher than forecast in DWR's calendar 2008 revenue requirement determination.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $10 million in 2009 due to lower than forecast variable rate debt service costs with the declining interest rate markets during the fiscal year, partially offset by the effects of refunding $523 million variable rate debt and remarketing $521 million of higher cost fixed rate debt which has semi-annual interest payments rather than monthly interest payments.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $70 million in 2008 due to lower than forecast variable rate debt service costs with the declining interest rate markets during the fiscal year, and the refunding of approximately $1.3 billion of variable rate debt with fixed rate debt which has semi-annual interest payments rather than monthly interest payments.

From the dates of issuance of the revenue bonds through June 30, 2009, 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 power and bond charges to IOU customers that have not yet been collected and amounts due from surplus sales of energy and gas. The current portion of recoverable costs at June 30, 2009 is $468 million, which is $43 million lower than at June 30, 2008. The decrease reflects slightly lower power sales volumes, as compared to fiscal year 2008, as a result of the economic downturn, combined with the effects of no longer receiving an allocation of surplus power sales from each IOU service territory beginning April 1, 2009, as a result of a CPUC ruling in connection with implementing operational changes to adapt to the California Independent System Operator's (the CAISO) Market Redesign Technology Upgrade (MRTU) launched on March 31, 2009. The lower expected surplus power sales is offset by slightly higher remittance rates per unit sold to customers after implementation of the 2009 revenue requirement, which forecast the operational change when filed.

The current portion of recoverable costs at June 30, 2008 is $99 million lower than at June 30, 2007. The decrease reflects lower power sales volumes after a large fixed volume contract was renegotiated to dispatchable capacity and the expiration of another fixed volume contract, both taking effect on January 1, 2008. The lower expected power sales is partially offset by higher remittance rates per unit sold after implementation of the 2008 revenue requirement, an increase in natural gas hedging settlement revenues and higher surplus gas sales revenues as a result of higher natural gas prices.

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 also hedges natural gas costs by transacting directly with counterparties. Assets in the brokerage account and certain bilateral hedge instruments are classified as other assets on the statements of net assets.

During 2009, other assets decreased by $189 million. The sharp decrease in market prices for natural gas resulted in declining values of outstanding hedges. DWR funded the hedge account with $290 million of cash throughout 2009 to absorb losses on hedge settlements, provide collateral for mark to market losses and enable future hedging transactions. At June 30, 2009, other assets consist of money market investments, US Treasury bills and government bonds valued at $47 million and financial options valued at $25 million.

During 2008, other assets increased by $170 million. DWR funded the account with $40 million of cash to enable future hedging transactions. The remainder of the increase is due to higher asset values resulting from the natural gas market prices rising with higher commodity prices throughout 2008. At June 30, 2008, other assets consist of money market investments, US Treasury bills and government bonds valued at $62 million and financial options valued at $199 million.

Long-Term Debt

Revenue bond principal payments were $493 million and $470 million in fiscal 2009 and 2008, respectively. Net amortization of bond premium and deferred loss on defeasance were $17 million and $18 million in fiscal 2009 and 2008, respectively.

During fiscal 2009, letters of credit enhancing $575 million of variable rate bonds expired December 1, 2008. Prior to the December 1, 2008 expiration date, DWR renewed a letter of credit enhancing $150 million of those bonds. On December 1, 2008 DWR successfully converted another $75 million of those variable rate bonds to fixed rate as part of a $173 million Series G conversion transaction. DWR converted $98 million Series G-4 bonds and the $75 million G-11 bonds to fixed rate with coupons ranging from 4.35% to 5.00%, while the maturity dates remained 2016 and 2018, respectively. The bonds were sold with a premium of $4 million and DWR incurred costs of issuance of $2 million, both of which will be amortized over the life of the bonds.

DWR was unsuccessful in renewing the credit facilities or converting to fixed rate bonds for the remaining $350 million of Series F bonds with expiring facilities. On December 1, 2008, those bonds became bank bonds and began incurring interest at prime plus 2% and were subject to an accelerated amortization schedule. In January 2009, DWR successfully converted the remaining $350 million bonds by remarketing $348 million of Series F fixed rate bonds. The bonds were sold with a premium of $4 million and DWR incurred costs of issuance of $2 million that will be amortized over the life of the bonds. Total revenue bonds outstanding decreased by $2 million as a result of the transaction. At June 30, 2009, there were no outstanding bank bonds.

The payment of principal and interest for all Series B bonds, $1.73 billion of Series C bonds, $409 million of Series F bonds, $46 million of Series G and all Series I and J bonds are paid from draws made under letters of credit, which expire in fiscal year 2011. The remaining Series C bonds of $496 million and $600 million of Series G bonds are credit enhanced by bond insurance for the timely payment of principal and interest. The liquidity facilities backing the $496 million of Series C bonds expire in fiscal year 2013. Four liquidity facilities backing $500 million Series G bonds expire in fiscal year 2011 and the final liquidity facility underlying $100 million expires in fiscal year 2013.

DWR is considering other options available to remedy any lack of credit capacity to renew all expiring agreements. DWR may convert the bonds to a fixed mode or plan a fixed refunding for all bonds where credit enhancement is not renewed, with identical maturities to the currently enhanced bonds.

During 2008, DWR issued an aggregate of $1.766 billion in refunding revenue bonds (Series H, I, J, and K) to refund $1.825 billion of outstanding 2002 Series C and D and 2005 Series G variable rate bonds. The proceeds of the refunding bonds, along with funds released from the Bond Charge Payment Account ($4 million) and Debt Service Reserve Account ($20 million), were used to purchase securities that were deposited in an irrevocable trust with an escrow agent to refund bonds and pay for underwriting fees and other issuance costs. The refunded bonds were all redeemed by May 2008.

Because the refunded bonds were variable rate bonds, the refunding did not result in an accounting loss.

Other Current Liabilities

Accounts payable at June 30, 2009 are $209 million lower than at June 30, 2008. The difference results from sharply lower costs for natural gas as result of the substantial decline in natural gas prices since the beginning of the fiscal year.

Accounts payable at June 30, 2008 are $22 million higher than at June 30, 2007. The difference results from higher costs for natural gas as result of the substantially higher natural gas prices and a $6 million liability for postretirement health and dental liabilities due to the implementation of Governmental Accounting Standards Board Statement No. 45***, Accounting and Financial Reporting by Employers for Post-Employment Benefits Other Than Pensions*** (GASB 45). These are offset by reduced power purchases after the renegotiation of the large fixed price contract and expiration of another contract.

Accrued interest payable at June 30, 2009 is $3 million higher than at June 30, 2008, and was $5 million higher at June 30, 2008 than at June 30, 2007 as the Fund has a higher percentage of fixed rate debt in the bond portfolio after reoffering / refunding transactions in both 2009 and 2008 increased fixed rate debt outstanding from the prior year. The higher fixed rate debt service costs in both years are offset by declining interest costs on the remaining variable debt as interest rate markets have declined.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Fund's activities for the years ended June 30, are summarized as follows (in millions):

	2009	2008	2007
Revenues:			
Power charges	$ 3,310	$ 3,794	$ 4,433
Surplus sales	294	529	410
Bond charges	873	868	855
Interest income	83	171	167
Total revenues	4,560	5,362	5,865
Expenses:			
Power purchases	3,930	4,356	4,732
Energy settlements	(30)	(32)	(47)
Interest expense	381	434	424
Other expenses	36	34	30
Recovery of recoverable costs	243	570	726
Total expenses	4,560	5,362	5,865
Net increase in net assets	-	-	-
Net assets, beginning of year	-	-	-
Net assets, end of year	$ -	$ -	$ -

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 are $484 million lower in fiscal 2009 than in the prior year. The difference reflects the lower volume of power sales to end use customers as a result of lower contract usage from dispatchable power plants combined with the renegotiation of a large fixed volume contract to dispatchable capacity and the expiration of another fixed volume contract, both taking effect on January 1, 2008. The lower volumes were partially offset by slightly higher per unit remittance rates implemented in January 2009 as part of the 2009 revenue requirement.

Power Charges were $639 million lower in fiscal 2008 than in the prior year. The difference reflects the lower volume of power sales to end use customers as a result of the renegotiation of a large fixed volume contract to dispatchable capacity, and the expiration of another fixed volume contract, both taking effect on January 1, 2008. The lower volumes were partially offset by higher per unit remittance rates implemented in January 2008 as part of the 2008 revenue requirement.

Surplus Sales

The Fund receives revenue from the sale of excess energy, based on DWR's pro-rata allocation of its share of energy provided to each IOU's service area to the total amount of energy provided by IOU generation in each respective IOU service area, and from the sale of surplus gas.

Surplus sales revenues were $235 million lower in 2009 than in 2008. Beginning April 1, 2009, the Fund no longer receives an allocation of surplus power sales from each IOU service territory as indicated in a CPUC ruling in connection with implementing operational changes to adapt to the CAISO MRTU launched on March 31, 2009. DWR forecasted this change in its 2009 revenue requirement and implemented remittance rates that will maintain required minimum balances in excess of bond indenture requirements.

Lower gas sales volumes and lower prices received per unit of power and gas sold also contributed to the lower amounts during the 2009 period as commodity market prices declined sharply.

Surplus sales revenues were $119 million higher in 2008 than in 2007. The increase is attributable to higher per unit prices received on sales of excess power and natural gas as commodity markets were volatile during the year. The higher prices for surplus energy sold were partially offset by 9% lower volumes sold.

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 years ended June 30, 2009, 2008 and 2007 were $873 million, $868 million and $855 million, respectively, and were 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 2009 was $88 million lower than in 2008, due to a combination of lower cash balances and investments, and the sharp decline in interest rates decreasing the interest earned on investments in the State of California Investment Pooled Money Investment Account-Surplus Investment Fund (SMIF). The average effective yield earned on SMIF balances was 2.19% and 4.38% for the years ended June 30, 2009 and 2008, respectively.

Interest income for 2008 was $4 million higher than in 2007. The increase was attributable to increased interest earned on investments in the SMIF from slightly higher cash and investment balances.

Power Purchases

Power costs are $426 million lower in 2009 than in 2008. The lower costs are attributable to sharply lower natural gas prices and lower volumes purchased after the renegotiation of a large fixed price contract to dispatchable capacity and the expiration of another fixed price contract, both taking effect January 1, 2008.

Power costs were $376 million lower in 2008 than in 2007. The difference is primarily a result of lower volumes purchased after the renegotiation of a large fixed price contract to dispatchable capacity and the expiration of another fixed price contract, both taking effect January 1, 2008. The decreased amount of power purchased is partially offset by higher costs for natural gas as a result of the substantially higher prices in 2008.

Energy Settlements

Energy settlements received, including those related to complex regulatory proceedings before the Federal Energy Regulatory Commission arising from events in California energy markets in 2001, are recorded as a decrease in operating expenses.

Energy settlements in 2009 total $30 million. The Fund received $12 million from a Kern River Gas Transmission company settlement as part of a FERC decision resetting its tariff rates for the past four years. The Fund received $4 million from the 2006 Enron Corp. settlement through bankruptcy court distributions. Other amounts owed from the Enron Corp. settlement are subject to future bankruptcy court distributions and will be recognized as an energy settlement if and when there is a distribution of monies. The Fund received an additional $14 million in other settlements, including $8 million from the California Power Exchange for receivable amounts that had been held in escrow until the bankruptcy court approved the release of funds.

Energy settlements in 2008 total $32 million. The Fund received $24 million from the 2006 Enron Corp. settlement through bankruptcy court distributions. The Fund received an additional $8 million in other settlements.

Future revenues under the Mirant Corporation, Reliant Energy, Dynegy Inc., 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.

Interest Expense

Interest expense was $53 million lower in 2009 when compared to 2008. The decrease is attributable to declining interest rates on variable rate debt during 2009 and lower debt outstanding. The decrease was partially offset by greater amounts of fixed rate debt outstanding in the portfolio as a result of the reoffering and refunding transactions in 2008 and 2009 described in the Long-Term Debt section of Management's Discussion and Analysis.

Interest expense was $10 million higher in 2008 when compared to 2007. The increase is attributable to greater amounts of fixed rate debt outstanding in the portfolio as a result of the refunding transactions in 2008. The increase was partially offset by declining interest rates on variable rate debt during 2008 and lower debt outstanding.

Other Expenses

Other expenses increased by $2 million in 2009 as a result of increased legal expenditures for contract renegotiations and ongoing litigation services regarding the 2000-2001 California energy crisis and an increase in charges for services provided to the Power Supply program by other state agencies, offset by an decrease in amounts for postretirement health and dental liabilities incurred by the Fund.

Other Expenses increased by $4 million in 2008 primarily as a result of the implementation of GASB 45.

Recovery (Deferral) of Recoverable Costs

The individual components of the recovery (deferral) of recoverable costs are as follows (in millions):

	2009	2008	2007
Operations	$ (332)	$ (35)	$ 128
Debt service and related costs	575	605	598
	$ 243	$ 570	$ 726

Operations
The $332 million deferral in the year ended June 30, 2009 reflected the planned under recovery of calendar 2008 operating costs while maintaining compliance with bond indenture requirements, offset by the unplanned receipt of $30 million in energy settlements and lower than forecast power costs due to the declining price of natural gas.

Debt Service and Related Costs
The recovery of debt service and related costs in all three years is a result of bond charges and interest income providing funds to pay interest expense and retire debt.

LIQUIDITY

On September 15, 2008, Lehman Brothers Holdings Inc. ("Lehman") filed for protection under Chapter 11 of the federal Bankruptcy Code in the United States Bankruptcy Court in the Southern District of New York. DWR has business relationships with subsidiaries of Lehman. DWR is a counterparty with Lehman Brothers Commodity Services Inc. ("LBCS") and Eagle Energy Partners 1, LP ("Eagle Energy"), subsidiaries of Lehman, in wholesale energy marketing transactions. Lehman Brothers Inc. ("LBI"), another Lehman subsidiary, was as a remarketing agent for $1.066 billion of outstanding DWR variable rate bonds.

The obligations of LBCS were guaranteed by Lehman, and the Lehman bankruptcy filing gave DWR the right to terminate the transactions with LBCS. DWR exercised its right to terminate the transactions with LBCS on September 18, 2008. As of the effective termination date DWR had net credit losses of under $1 million, and issued a demand notice for amounts owed. There has been no progress to date in settling these credit losses.

The obligations of Eagle Energy were not guaranteed by Lehman on the date of bankruptcy filing. At that time DWR had no credit exposure to Eagle Energy, as DWR was a net buyer of natural gas from Eagle for August and the first half of September 2008. Subsequently, Eagle Energy was purchased by Électricité de France. DWR continues to transact with Eagle Energy after the acquisition.

After the bankruptcy filing, Barclays Bank Plc purchased the broker-dealer operations of LBI and continues to remarket the bonds.

Department of Water Resources Electric Power Fund
Statements of Net Assets
June 30, 2009 and 2008 (in millions)

	2009	2008
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 543	$ 548
Debt Service Reserve Account	950	917
Recoverable costs, net of current portion	5,691	5,934
Total long-term assets	7,184	7,399
Current assets:		
Restricted cash and equivalents:		
Operating and Priority Contract Accounts	964	1,227
Bond Charge Collection and Bond Charge Payment Accounts	629	619
Recoverable costs, current portion	468	511
Interest receivable	13	27
Other assets	72	261
Total current assets	2,146	2,645
Total assets	$ 9,330	$ 10,044
Capitalization and Liabilities		
Capitalization:		
Net assets	$ -	$ -
Long-term debt	8,471	8,999
Total capitalization	8,471	8,999
Current liabilities:		
Current portion of long-term debt	530	510
Accounts payable	266	475
Accrued interest payable	63	60
Total current liabilities	859	1,045
Commitments and Contingencies (Note 7)		
Total capitalization and liabilities	$ 9,330	$ 10,044

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 years ended June 30, 2009 and 2008 (in millions)

	2009	2008
Operating revenues:		
Power charges	$ 3,310	$ 3,794
Surplus sales	294	529
Total operating revenues	3,604	4,323
Operating expenses:		
Power purchases	3,930	4,356
Energy settlements	(30)	(32)
Administrative expenses	36	34
(Deferral) recovery of recoverable operating costs	(332)	(35)
Total operating expenses	3,604	4,323
Income from operations	-	-
Bond charges	873	868
Interest income	83	171
Interest expense	(381)	(434)
Recovery of recoverable debt service and related costs	(575)	(605)
Net increase in net assets	-	-
Net assets, beginning of year	-	-
Net assets, end of year	$ -	$ -

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

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the years ended June 30, 2009 and 2008 (in millions)

	2009	2008
Cash flows from operating activities:		
Receipts:		
Power charges	$ 3,277	$ 3,942
Surplus sales	368	481
Energy settlements	30	32
Payments for power purchases and other expenses	(3,986)	(4,539)
Net cash used in operating activities	(311)	(84)
Cash flows from non-capital financing activities:		
Receipt of bond charges	875	867
Bond payments	(493)	(470)
Interest payments	(399)	(447)
Proceeds from issuance of revenue bonds	529	1,827
Defeasance of revenue bonds	(523)	(1,825)
Net cash used in non-capital financing activities	(11)	(48)
Cash flows from investing activities:		
Interest received on investments	97	185
Proceeds from termination of guaranteed investment contract	150	150
Net cash provided by investing activities	247	335
Net (decrease) increase in cash and equivalents	(75)	203
Restricted cash and equivalents, beginning of year	2,861	2,658
Restricted cash and equivalents, end of year	$ 2,786	$ 2,861
Restricted cash and equivalents included in:		
Operating Reserve Account	$ 543	$ 548
Debt Service Reserve Account (a component of the total of $950 and $917 at June 30, 2009 and 2008, respectively)	650	467
Operating and Priority Contract Accounts	964	1,227
Bond Charge Collection and Bond Charge Payment Accounts	629	619
Restricted cash and equivalents, end of year	$ 2,786	$ 2,861
Reconciliation of operating income to net cash used in operating activities:		
Income from operations	$ -	$ -
Adjustments to reconcile operating income to net cash used in operating activities:		
Deferral of recoverable operating costs	(332)	(35)
Other changes in operating assets and liabilities:		
Recoverable costs	41	(28)
Other assets	189	-
Accounts payable	(209)	(21)
Net cash used in operating activities	$ (311)	$ (84)

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, net assets, 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 June 30, 2009 and 2008, and the changes in its financial position and its cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Restricted Cash, Equivalents and Investments
Under the terms of the Bond Indenture, separate restricted cash and investment accounts were established. The accounts and their purpose follow:

Power Charge Accounts:

- Operating Account: Power charges (see Revenues and Recoverable Costs) and miscellaneous revenue are deposited into the Operating Account. Monthly, funds are transferred to the Priority Contract Account as needed to make payments on priority contracts. Remaining monies are available for payment of all operating costs of the Fund other than priority contracts, debt service, and debt-related costs.

- Priority Contract Account: Priority contracts are those power purchase contracts that require monthly payment prior to any debt service payments. Monies in the Priority Contract Account are used to make scheduled payments on priority contracts. After the monthly transfer from the Operating Account on the fifth of the month, the Priority Contract Account is projected to have monies sufficient to make scheduled payments on priority contracts through the fifth of the following month.

- Operating Reserve Account: The Operating Reserve account must maintain a balance equal to the greater of (i) seven months of projected negative operating cash flows under a stress scenario, as defined, or (ii) twelve percent of projected annual operating expenses of the Fund, as defined.

Bond Charge Accounts:

- Bond Charge Collection Account: Bond charges (see Revenues and Recoverable Costs) are deposited into the Bond Charge Collection Account. Monthly, funds needed for debt service payments are transferred to the Bond Charge Payment Account.

- Bond Charge Payment Account: Monies in the Bond Charge Payment Account are used to pay debt service, swap payments and related fees for the revenue bonds. After receipt of the monthly transfer from the Bond Charge Collection Account, the balance in the Bond Charge Payment Account must at least equal debt service, swap payments and fees estimated to accrue or be payable for the next succeeding three months.

- Debt Service Reserve Account: The Debt Service Reserve account is to be funded at all times with the amount of maximum aggregate annual debt service on all outstanding debt, including net scheduled swap payments.

Restricted cash and equivalents, for purposes of the statements of cash flows, include cash on hand and deposits in the State of California Investment Pooled Money Investment Account-Surplus Money Investment Fund (SMIF).

SMIF has an equity interest in the State of California Pooled Money Investment Account (the PMIA). Generally, the investments in the PMIA are available for withdrawal on demand. The PMIA cash and investments are recorded at amortized cost, which approximates market. The PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, described in Note 3 below.

Long-term investments are held solely in the Debt Service Reserve Account by the bond co-trustee and consist of guaranteed investment contracts (GICs) and a U.S. government backed agency security in accordance with a forward purchase agreement (the FPA). The GICs are carried at cost and the U.S. government backed agency security is carried at amortized cost.

Other Assets
The Fund enters into futures and option contracts for the purpose of hedging of natural gas fuel costs. The substantial majority of the next year's gas requirements are hedged through these instruments. The Fund does not enter into natural gas futures and option agreements for trading purposes, but rather to take advantage of favorable pricing and to reduce fuel price volatility. The Fund does not take delivery on these contracts; rather the contracts are financially settled, usually at the approximate maturity dates of the instruments.

Option agreements are reported at fair value and are included in other assets on the statement of net assets. At June 30, 2009 and 2008 those amounts were $25 million and $199 million, respectively. Fair value is determined based on market quotes for those or similar instruments on active exchanges. Realized and unrealized gains and losses on such contracts are reflected as changes to fuel operating costs which are included in power purchases in the statement of revenues, expenses and changes in net assets.

The Fund is exposed to additional fuel price risk if the counterparties default. Further, volatility of the market prices could reduce the value of the contracts.

Future gas purchase contracts are recorded at amortized cost, if any. As described in Note 7, such contracts are considered derivatives for financial reporting purposes.

The brokerage firm that facilitates certain of the Fund's hedging contracts requires that the Fund maintain a security deposit, which is invested in compliance with the California Government Code. These funds are invested in money market mutual funds and government bonds and are carried at fair value. The investment in money market mutual funds amounted to $47 million and $46 million at June 30, 2009 and 2008, respectively. There were no investments in treasury bills and government bonds at June 30, 2009 while there was $16 million invested in treasury bills and government bonds at June 30, 2008 which are included in other assets on the statement of net assets.

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 CPUC which then sets customer remittance rates. The Fund's financial statements are prepared in accordance with Topic 980 of the Financial Accounting Standards Board Codification, "*Regulated Operations*", 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 the Fund 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, the IOU, or an ESP, is delivered to IOU or ESP customers. Costs are recovered over the life of the bonds (2022) as determined by DWR's revenue requirement process.

Surplus sales represent DWR's 1) allocated portion of the IOUs total surplus energy sales, and 2) the sale of gas not needed for the generation of power. Through March 2009, the revenue from the sale of excess energy by the IOUs was shared on a pro-rata basis between DWR and the IOUs, based on the amount of energy provided by DWR relative to the total amount of energy provided from IOU generation in the individual IOU's service territory. Beginning April 1, 2009, the Fund no longer receives an allocation of surplus power sales from each IOU service territory as indicated in a CPUC ruling in connection with implementing operational changes to adapt to the California Independent System Operator's (the CAISO) Market Redesign Technology Upgrade (MRTU) launched on March 31, 2009. Revenues for sales of surplus gas are still received.

New Accounting Pronouncement

GASB 53 Accounting and Financial Reporting for Derivative Instruments

For the year ended June 30, 2010, the Fund will be required to implement Governmental Accounting Standards Board Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB 53). GASB 53 establishes accounting and financial reporting standards for the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. The Fund is party to derivative financial instruments, consisting of interest rate swap agreements, gas price swap agreements, option agreements, and gas and electricity purchase agreements. Under the provisions of GASB 53, derivatives that are not considered to be normal purchases or normal sales are recorded at fair value on the balance sheet. GASB 53 defines normal purchases and normal sales as contracts that are for the purchase or sale of a commodity, such as natural gas or electricity, to be used in the normal course of operations, provided that it is probable DWR will take delivery of the commodity specified in the derivative instrument. Changes in the fair value of derivatives that do not meet the requirements of an effective hedge transaction will be included in investment income as required under GASB 53. Changes in the fair value of derivatives which are effective hedges, will be deferred on the balance sheet and included in prepaid expenses and other current assets. The fair value of a derivative instrument is either the value of its future cash flows in today's dollars or the price it would bring if it could be sold on an open market. DWR is currently evaluating the impact of GASB 53 on the Fund's financial statements.

3. Restricted Cash and Investments

The State of California has a deposit policy to address custodial credit risk. As of June 30, 2009 and 2008, $6 million and $16 million, respectively, of the Fund's cash balances were uninsured and uncollateralized.

As of June 30, 2009 and 2008, the Fund had the following cash, cash equivalents and investments (in millions):

Investment	Maturity	2009	2008
State of California Pooled Money Investment Account - State Money Investment Fund	7.8 months average	$ 2,752	$ 2,831
Cash		34	30
Total cash and equivalents		2,786	2,861
Guaranteed investment contracts	May 1, 2022	200	350
Forward purchase agreement	November 1, 2009	100	100
		$ 3,086	$ 3,311
Reconciliation to Statement of Net Assets:			
Operating Reserve Account		$ 543	$ 548
Debt Service Reserve Account		950	917
Operating and Priority Contract Accounts		964	1,227
Bond Charge Collection and Bond Charge Payment Accounts		629	619
		$ 3,086	$ 3,311

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 GICs and the FPA are rated as follows, by Standard & Poor's (S&P) and Moody's, respectively, at June 30, 2009 (in millions):

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

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 1.4% and 2.9% at June 30, 2009 and 2008, respectively. For the years ended June 30, 2009 and 2008, interest earned on the deposit in the PMIA was $61 million and $128 million, respectively. Additionally during the year ended June 30, 2008, the Fund earned $15 million on bond issuance proceeds while in escrow, which was paid to the Fund upon the close of escrow.

Interest on the GICs is paid semi-annually at interest rates ranging from 5.3% to 5.5%. Interest earned on the GICs was $17 million and $23 million for the years ended June 30, 2009 and 2008, respectively. In both 2009 and 2008, a GIC valued at $150 million was redeemed and the proceeds were invested in SMIF.

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 to mature every six months. Interest earned on the FPA was $5 million for the years ended June 30, 2009 and 2008.

4. Long-Term Debt

The following activity occurred in the long-term debt accounts during the years ended June 30, 2009 and 2008 (in millions):

	Revenue Bonds	Unamortized Premium	Deferred Loss on Defeasance	Total
Balance, June 30, 2007	$ 10,054	$ 137	$ (196)	$ 9,995
Refunding				
Issuance of debt	1,766	61	-	1,827
Defeasance of debt	(1,825)	-	-	(1,825)
Payments	(470)	-	-	(470)
Amortization	-	(32)	14	(18)
Balance, June 30, 2008	9,525	166	(182)	9,509
Reoffering				
Issuance of debt	521	8	-	529
Defeasance of debt	(523)	-	(4)	(527)
Payments	(493)	-	-	(493)
Amortization	-	(32)	15	(17)
Balance, June 30, 2009	9,030	142	(171)	9,001
Less current portion	518	28	(16)	530
	$ 8,512	$ 114	$ (155)	$ 8,471

Long-term debt consists of the following at June 30, 2009 and 2008, respectively (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding 2009	2008
A	Fixed (3.1-6.0%)	2018	2012	$ 2,458	$ 2,826
B	Variable	2020	Callable	1,000	1,000
C	Variable	2021	Callable	2,229	2,333
F	Variable	2022	Callable	409	759
F	Fixed (4.375-5.0%)	2022	Callable	348	-
G	Variable	2018	Callable	646	841
G	Fixed (4.35-5.0%)	2016/18	Callable	173	-
H	Fixed (3.75-5.0%)	2022	2018	1,007	1,007
I	Variable	2022	Callable	150	150
J	Variable	2018	Callable	330	330
K	Fixed (4.9-5.0%)	2018	Non-callable	279	279
				$ 9,030	$ 9,525
Plus unamortized bond premium				142	166
Less deferred loss on defeasance				(171)	(182)
Less current maturities				(530)	(510)
				$ 8,471	$ 8,999

Debt transactions
During the year-ended June 30, 2009 DWR executed debt-related transactions in order to reduce dependencies on credit support facilities that were expiring or negatively impacted by economic uncertainties in the credit markets, and to reduce prospective interest rate risk. In December, 2008 DWR converted $173 million of Series G variable-rate bonds fixed rate bonds.

In January 2009, DWR converted $348 million of Series F variable-rate bonds to fixed rate bonds. In total these conversion and remarketing transactions generated premiums of $8 million and debt issuance costs of $4 million which are being amortized over the remaining lives of the bonds.

During the year ended June 30, 2008, DWR issued an aggregate $1.766 billion in refunding revenue bonds (Series H, I, J, and K) to refund $1.825 billion of outstanding 2002 Series C and D and 2005 Series G variable rate bonds. The proceeds of the refunding bonds, along with funds released from the Bond Charge Payment Account ($4 million) and Debt Service Reserve Account ($20 million), were used to purchase securities that were deposited in an irrevocable trust with an escrow agent to refund bonds and pay for underwriting fees and other issuance costs. The refunded bonds were all redeemed by May 2008.

Because the refunded bonds were variable rate bonds, the refunding did not result in an accounting loss.

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%. All other callable bonds are redeemable at 100%.

DWR's variable rate bonds have either daily or weekly rate reset modes. The variable rate bonds have a final stated maturity of 2022, but are scheduled to be retired in sinking fund installments from 2008 to 2022. The interest rates for the variable debt for the year ended June 30, 2009 and 2008, ranged from 0.05% to 10.00% and from 0.30% to 10.94%, respectively.

The payment of principal and interest for all Series B bonds, $1.73 billion of Series C bonds, $409 million of Series F bonds, $46 million of Series G and all Series I and J bonds are paid from draws made under letters of credit. Draws made under the letters of credit are to be reimbursed on the same day by the Fund. Bonds purchased under the letters of credit are required to be redeemed in equal installments over a three year period beginning six months after the termination date of the letter of credit. There are no outstanding amounts on the letters of credit at June 30, 2009. The Fund pays fees of 0.45% per annum on the stated amount of the letters of credit for the Series B and C bonds, in a range from 0.35% to 0.38% per annum on the stated amount for the Series F and G bonds, and 0.53% per annum on the stated amount for the Series I and J bonds. All Series B, C, F, G, I and J letters of credit expire in fiscal year 2011.

Remarketing, credit support and related uncertainties

DWR bonds are remarketed by fourteen different broker-dealer remarketing agents, with credit enhancement provided by twenty one 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, DWR is required to pay a stated fixed interest rate quarterly until the bonds are successfully remarketed. If the agreements expire or are terminated, DWR is required to begin paying principal in quarterly installments nine months after termination. Early repayment requirements vary with each type of credit facility. Letters of credit require DWR to repay the bonds in eleven equal quarterly installments, while liquidity facilities require repayment in nineteen or twenty seven equal quarterly installments depending on the provider.

During the year ended June 30, 2009, negative credit market impacts increased borrowing costs on variable rate bonds that experienced interest rate resets at higher rates and on occasion caused 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 June 30, 2009, there were no outstanding bank bonds.

At June 30, 2009, $496 million of Series C bonds and $600 million of Series G 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 AAA/Aa3 by S&P and Moody's at June 30, 2009. 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 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 June 30, 2009. The liquidity facilities backing the $496 million of Series C bonds expire in fiscal year 2013. The Fund pays fees of 0.22% to 0.28% per annum under the Series C liquidity facilities. Four liquidity facilities backing $500 million of Series G bonds expire in fiscal year 2011 and the final liquidity facility underlying $100 million expires in fiscal year 2013. The Fund pays fees of between 0.15% to 0.19% per annum under the Series G liquidity facilities.

DWR is considering other options available to remedy any lack of credit capacity to renew all expiring agreements. DWR may convert the bonds to a fixed mode or plan a fixed refunding for all bonds where credit enhancement is not renewed, with identical maturities to the currently enhanced bonds.

Maturities
Future payment requirements on the revenue bonds are as follows at June 30, 2009 (in millions):

Fiscal Year	Principal	Interest [1]	Total
2010	$ 518	$ 229	$ 747
2011	545	209	754
2012	573	191	764
2013	602	170	772
2014	635	142	777
2015-2019	3,601	452	4,053
2020-2022	2,556	125	2,681
	$ 9,030	$ 1,518	$ 10,548

[1] Variable portion of interest cost calculated using the June 30, 2009 Securities Industry and Financial Markets Association Swap Index (SIFMA).

5. Interest Rate Swaps

DWR, on behalf of the Fund, entered into interest rate swap agreements with various counterparties to reduce variable interest rate risk. The swaps create a synthetic fixed rate for DWR. DWR has agreed to make fixed rate payments and receive floating rate payments on notional amounts equal to a portion of the principal amount of DWR’s variable rate debt.

The terms, fair values, and credit ratings of counterparties for the various swap agreements at June 30, 2009 are summarized in the following table (in millions):

Outstanding Notional Amount	Fixed Rate Paid by Fund	Variable Rate [1] Received by Fund	Fair Value gain (loss)	Swap Termination Date	Counterparty Credit Rating S&P	Moody's	Fitch
$ 94	2.914%	67% of LIBOR	$ (4)	May 1, 2011	AAA	Aaa	AAA
234	3.024%	67% of LIBOR	(12)	May 1, 2012	AAA	Aaa	AAA
127	3.405%	SIFMA	(5)	May 1, 2013	AA-	Aa1	AA-
63	3.405%	SIFMA	(3)	May 1, 2013	A	A2	A
19	3.405%	SIFMA	(1)	May 1, 2013	A	A2	A+
194	3.204%	67% of LIBOR	(12)	May 1, 2014	A+	Aa3	A+
265	3.184%	66.5% of LIBOR	(15)	May 1, 2015	BBB	A3	A-
174	3.280%	67% of LIBOR	(12)	May 1, 2015	AAA	Aaa	AAA
202	3.342%	67% of LIBOR	(14)	May 1, 2016	AA	Aa1	AA
485	3.228%	66.5% of LIBOR	(32)	May 1, 2016	AA	Aa1	AA
202	3.389%	67% of LIBOR	(15)	May 1, 2017	A	A2	A
480	3.282%	66.5% of LIBOR	(30)	May 1, 2017	AA	Aa2	AA
514	3.331%	66.5% of LIBOR	(31)	May 1, 2018	A+	Aa1	AA-
306	3.256%	64% of LIBOR	(17)	May 1, 2020	A+	Aa1	AA-
453	3.325%	64% of LIBOR	(23)	May 1, 2022	AA-	Aaa	AA
$ 3,812			$ (226)				

[1] One month U.S. Dollar London Interbank Offered Rate or Securities Industry and Financial Markets Association Swap Index (SIFMA) (formerly BMA)

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 June 30, 2009, the variable rates on DWR's hedged bonds ranged from 0.10% to 3.00%, while the variable rates received on the LIBOR-based swaps were 0.20% to 0.21% and the variable rate received on the SIFMA-based swap was 0.35%.

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

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 basis risk results from the fact that DWR's floating interest payments payable on the underlying debt are determined in the tax-exempt market, while DWR's floating receipts on the swaps are based on LIBOR, which is determined in the taxable market. When the relationship between LIBOR and the tax-exempt market change and move to convergence, or DWR's bonds trade at levels higher in rate in relation to the tax-exempt market, DWR's all-in costs would increase.

DWR has entered into basis swaps to mitigate this risk and optimize debt service by changing the variable rate received by the Fund to a five year Constant Maturity Swap Index (CMS). The terms, fair values, and credit ratings of counterparties for the various basis swap agreements at June 30, 2009 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 gain (loss)	Swap Termination Date	Counterparty Credit Rating S&P	Moody's	Fitch
$ 234	67% of LIBOR	62.83% of CMS	$ 8	May 1, 2012	AA	Aa1	AA
194	67% of LIBOR	62.70% of CMS	8	May 1, 2014	A+	Aa1	AA-
174	67% of LIBOR	62.60% of CMS	7	May 1, 2015	AA-	Aa1	AA-
202	67% of LIBOR	62.80% of CMS	9	May 1, 2016	AA	Aa1	AA
202	67% of LIBOR	62.66% of CMS	9	May 1, 2017	AA-	Aa1	AA-
$ 1,006			$ 41				

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

2 Five year Constant Maturity Swap

As of June 30, 2009, 67% of LIBOR paid on the basis swaps was equal to 0.21% while the variable rates received based on the five year CMS Index was 1.85%.

Net amounts paid under all swaps amounted to $75 million and $18 million for the years ended June 30, 2009 and 2008, respectively.

Credit Risk: The Fund has a total of twenty swap agreements with ten different counterparties at June 30, 2009. DWR’s policies limit the amount of notional exposure to a single counterparty at no more than 25 percent. Approximately 23 percent of the swaps' total notional value is with a single counterparty with a credit rating of AA/Aa1/AA, while 21 percent of the total notional value is held with another counterparty with credit ratings of A+/Aa1/AA-. The remaining swaps are with separate counterparties, all having BBB/A3/A- ratings or better.

Termination Risk: The Fund's swap agreements do not contain any out-of-the-ordinary termination provisions that would expose it to significant termination risk. In keeping with market standards, DWR or the counterparty may terminate a swap agreement if the other party fails to perform under the terms of the contract. In addition, the swap documents allow either party to terminate in the event of a significant loss of creditworthiness by the other party. If a termination were to occur, at the time of the termination, the Fund would be liable for payment equal to the swap’s fair value, if it had a negative fair value at that time. The counterparty would be liable for any payment equal to the swap’s fair value, if it had positive fair value at that time. As of June 30, 2009, the ratings published by a ratings agency for one Fund swap counterparty, has fallen below the A- level that would allow DWR to terminate the swap. At this time DWR is not planning to terminate based on the swap having a valuation that would create a liability for the Fund and therefore, does not create any credit risk. In addition, a termination would mean that the Fund's underlying floating rate bonds would no longer be hedged and the Fund would be exposed to floating rate risk, unless it entered into a new hedge following termination.

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 June 30, 2009, 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):

	Variable Rate Bonds		Interest Rate	
Fiscal Year	**Principal**	**Interest**	**Swaps, Net**	**Total**
2010	$ 80	$ 13	$ 99	$ 192
2011	241	13	96	350
2012	258	12	90	360
2013	54	11	86	151
2014	221	11	84	316
2015-2019	2,365	32	266	2,663
2020-2022	593	4	39	636
	$ 3,812	$ 96	$ 760	$ 4,668

6. Retirement Plan and Postretirement Benefits

Retirement Plan Description

The State of California is a member of the California Public Employees' Retirement System (PERS), an agent multiple-employer pension system that provides a contributory defined-benefit pension for substantially all State employees. DWR is included in the State Miscellaneous Category (Tier 1 and Tier 2) within PERS, thereby limiting the availability of certain DWR pension data. PERS functions as an investment and administrative agent for participating public agencies within the State of California. Departments and agencies within the State of California, including DWR, are in a cost-sharing arrangement in which all risks and costs are shared proportionately by participating State agencies. Copies of PERS' comprehensive annual financial report may be obtained from their executive office at 400 P Street, Sacramento, California 95814. The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon an employee's years of credited service, age and final compensation. Vesting occurs after five years of credited service except for second tier benefits, which require ten years of credited service. Employees who retire at or after age 50 with five or more years of service are entitled to a retirement benefit, payable monthly for the remainder of their lives. Several survivor benefit options which reduce a retiree's unmodified benefit are available. Benefit provisions and all other requirements are established by state statute.

Annual Pension Cost

For the years ended June 30, 2009 and 2008, DWR's annual pension cost payable from the Fund and actual contribution allocated to the Fund based on the Fund's payroll costs approximated $1 million per year.

Postretirement Benefits
In addition to the pension benefits, the State of California provides post-retirement health care benefits, in accordance with Section 22754(g) of the State Government Code, to all employees who retire on or after attaining certain age and length of service requirements. The State of California is funding postretirement benefits on a pay-as-you-go basis. The annual required contribution for the Fund amounted to $1.3 million and $8.6 million for the years ended June 30, 2009 and 2008, respectively. During fiscal year 2009, DWR modified its allocation method of post-retirement health care costs between DWR funds. The allocation method is now based on labor costs. As a result, the Fund's net OPEB obligation of $6 million at June 30, 2008 was reduced to $2 million at June 30, 2009. The Fund's annual required contribution represents 0.03% of the State's total annual required contribution for the year ended June 30, 2009. The State's unfunded actuarial accrued liability at July 1, 2009 attributable all State employees is projected to be $51 billion.

7. 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 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).

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.

DWR 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 DWR is still supplying power under the Act. However, the decision continued the proceeding to consider possible approaches to expediting DWR'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 DWR from its role as supplier of power to retail electric customers. Under this plan, DWR's power purchase contracts would be replaced by agreements between the IOUs and DWR's power supplier counterparties that are not detrimental to ratepayers, through novation and/or negotiation. The decision sets a goal for the execution of replacement agreements for all of the Power Purchase Contracts by January 1, 2010. Although the CPUC decision sets a goal of January 1, 2010 for the removal of DWR from all of its power purchase contracts, that is not the target date for reopening direct access to bundled customers.

Provisions in 22 out of the 26 remaining DWR power purchase contracts would, if certain conditions are satisfied (including a minimum credit rating requirement for the IOU in some contracts), allow for DWR to novate the contract to a qualifying IOU. DWR'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 DWR'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

While the CPUC has set a goal of novating contracts as early as January 1, 2010, numerous conditions would 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.

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 seven years. Payments under these and gas purchase contracts approximated $3.9 billion and $4.3 billion for fiscal 2009 and 2008, respectively.

The remaining amounts of fixed obligations under the contracts as of June 30, 2009, are as follows (in millions):

Fiscal Year	Fixed Obligation
2010	$ 1,923
2011	1,463
2012	631
2013	61
2014	15
2015	4
	$ 4,097

In addition to the fixed costs there are variable costs under several of the contracts. Management projected as of June 30, 2009 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $6 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. The Fund enters into forward gas futures contracts to hedge the cost of natural gas.

All of the power purchase contracts and gas purchase contracts are considered derivatives 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* (GASB TB 03-1). Most of the power purchase contracts qualify as normal purchases under GASB TB 03-1 and as a result, market valuation and certain risk information are not required to be disclosed.

Five power purchase contracts do not qualify as normal purchases and normal sales under the provisions of GASB TB 03-1 because either the pricing terms contain variables which are not clearly and closely related to the base energy price or the seller is not a generator of electricity. The fair value of these five contracts at June 30, 2009 and 2008 are approximately a $(496) million loss and a $459 million gain, respectively, based on quoted prices and price curves for derivatives. These contracts, with a total capacity of 2,135 MWh at June 30, 2009, expire at various times, from December 2010 through December 2011.

DWR also has entered into transactions to hedge the price of natural gas through bilateral arrangements. These contracts are considered derivatives and are not considered normal purchases or normal sales under GASB TB 03-1. The fair value of the various transactions at June 30, 2009 and 2008 approximated $(18) million and $292 million, respectively, using forward market prices. The transaction volumes vary in size from 323 to 20,000 mmBtu per day, and they expire at various times from August 2009 through December 2012.

Credit Risk: Since DWR is a net buyer under all power purchase contracts and the majority of DWR’s power purchase contracts are valued in the counterparties' favor, DWR management does not believe there is substantial credit risk. There are no contacts that were valued in DWR’s favor at June 30, 2009 given the sharp decline in energy and natural gas prices.

DWR has open natural gas hedge positions with twelve different counterparties at June 30, 2009. All counterparties have credit ratings of at least A-/A2. At June 30, 2009, DWR has credit risk exposure to two counterparties, both rated A/A1 since the value is in DWR’s favor for $3.3 million and $3.7

million. DWR management believes there is no substantial credit exposure to the remaining ten counterparties, as the sharp decrease of natural gas prices has resulted in valuations in the counterparties' favor.

Termination Risk: None of the power purchase contracts have termination provisions that would require DWR to make payment in the event of a counterparty default. DWR is only required to make a termination payment upon a DWR default and the contract values in favor of the counterparty.

With regards to gas hedge agreements, DWR 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, DWR or the counterparty would owe the other a payment equal to the open positions fair value in their favor.

8. Energy Settlements

DWR 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.

Energy settlements in 2009 total $30 million. The Fund received $12 million from a Kern River Gas Transmission company settlement as part of a FERC decision resetting its tariff rates for the past four years. The Fund received $4 million from the 2006 Enron Corp. settlement through bankruptcy court distributions. Other amounts owed from the Enron Corp. settlement are subject to future bankruptcy court distributions and will be recognized as an energy settlement if and when there is a distribution of monies. The Fund received an additional $14 million in other settlements from various companies, including $8 million from the California Power Exchange for collateral and receivable amounts that had been held in escrow until the bankruptcy court approved the release of funds.

Energy settlements in 2008 total $32 million. The Fund received $24 million from the 2006 Enron Corp. settlement through bankruptcy court distributions. Other amounts owed from the Enron Corp. settlement are subject to future bankruptcy court distributions and will be recognized as an energy settlement if and when there is a distribution of monies. The Fund received an additional $8 million in other settlements.

Future revenues under the Mirant Corporation, Reliant Energy, Dynegy Inc, 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.

9. Related Party Transactions

The California State Teachers’ Retirement System (STRS) and PERS, which are part of the California state government, participate in the Fund's letters of credit with three financial institutions. The total commitment for two letters of credit underlying the STRS’ participation approximates $175 million and expires on November 30, 2010. The total commitment for the two letters of credit underlying the PERS’ participation approximates $80 million and expires on April 15, 2011. There are no outstanding amounts on the letters of credit at June 30, 2009 or 2008.