Department of Water Resources
Electric Power Fund
Financial Statements

For the years ended June 30, 2010 and 2009

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, 2010 and 2009, 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 present only the Fund and do not purport to, and do not, present fairly the financial position of the State of California at June 30, 2010 and 2009, or the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, during the year ended June 30, 2010, the Fund adopted the provisions of Governmental Accounting Standards Board Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.*

The accompanying Management's Discussion and Analysis presented on pages 2 through 12 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 29, 2010

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.

The Fund 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 the Fund. However, the Fund 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 the Fund. Most of the volume of power under contract expires by December 31, 2011 and the last of the contracts expires in 2015.

The Fund 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 the Fund, 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):

	2010	2009 (As Restated)	2008
Long-term restricted cash, equivalents and investments	$ 1,490	$ 1,493	$ 1,465
Recoverable costs	4,881	5,653	5,934
Derivative instruments	25	90	-
Deferral of derivative cash outflows	195	434	-
Restricted cash and equivalents:			
Operating and priority contract accounts	1,257	964	1,227
Bond charge collection and bond charge payment accounts	630	629	619
Recoverable costs, current portion	339	468	511
Interest receivable	7	13	27
Other assets	92	47	261
Total assets	$ 8,916	$ 9,791	$ 10,044
Net assets	$ -	$ -	$ -
Long-term debt, including current portion	8,417	9,001	9,509
Derivative instruments	203	446	-
Deferral of derivative cash inflows	8	15	-
Other current liabilities	288	329	535
Total capital and liabilities	$ 8,916	$ 9,791	$ 10,044

In the year ended, June 30, 2010 the Fund adopted Government Accounting Standards Board Standard No. 53 (GASB 53) which changed their accounting for commodity and hedge transactions which are determined to be derivatives. In accordance with the transition provisions of GASB 53, the change in accounting was applied retrospectively for the year ended June 30, 2009. As such financial information for fiscal 2010 and 2009 is presented in a consistent manner in both the accompanying financial statements and this management discussion and analysis (MD&A). However, fiscal 2008 financial information presented in this MD&A has not been revised. Since the implementation of GASB 53, did not impact net assets or changes in net assets during any period presented, management does not consider this inconsistency to be consequential in the overall context of this MD&A.

Long-Term Restricted Cash, Equivalents and Investments

The $3 million decrease in long-term restricted cash, equivalents and investments during fiscal 2010 is a combination of a $6 million increase in the Operating Reserve Account and a $9 million decrease in the Debt Service Reserve Account.

The Operating Reserve Account increased by $6 million to $549 million. 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 2010 as forecast in the Fund's 2010 revenue requirement determination. The Debt Service Reserve Account decreased to $941 million due to decreased debt service cost assumptions resulting from a bond refunding transaction in May 2010, highlighted below in the Long Term Debt section.

The Operating Reserve Account decreased by $5 million to $543 million in 2009 as forecasted power costs in the Fund's 2009 revenue requirement were similar to the prior year and no contracts expired or were renegotiated during the year. The Fund 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 in 2009 due to increased debt service cost assumptions resulting from bond refunding transactions in 2008 and 2009.

Recoverable Costs, Net of Current Portion

Long-term recoverable costs consist of costs that are recoverable through future billings. The $772 million decrease during fiscal 2010 is due to 1) operating revenues exceeding operating expenses by $227 million, as a result of the collection of higher remittances than necessary to pay power costs due to the lower than projected prices for natural gas, combined with 2) bond charges plus interest income exceeding interest and investment expense by $544 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 $281 million decrease during fiscal 2009, as restated due to adoption of GASB 53, is due to 1) operating expenses exceeding operating revenues by $344 million, and 2) bond charges plus interest income exceeding interest and investment expense by $600 million.

Restricted Cash, Equivalents and Investments

The Operating and Priority Contract Accounts increased by $293 million in 2010 due to lower than expected costs in the first six months of the fiscal year along with $48 million in cash received from energy settlements. The $1,257 million balance in the Operating and Priority Contract Accounts at June 30, 2010 is $195 million higher than forecast in the Fund's calendar 2010 revenue requirement determination.

The Operating and Priority Contract Accounts decreased by $263 million in 2009 as the Fund 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 the Fund'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 the Fund received $30 million in cash received from energy settlements.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $1 million in 2010 as debt service costs related to scheduled interest payments were similar with the lower than expected variable rates from declining interest rate markets offset higher fixed rate debt service costs during the fiscal year.

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.

From the dates of issuance of the revenue bonds through June 30, 2010, 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 and litigation settlements. The $339 million current portion of recoverable costs at June 30, 2010 is $129 million lower than at June 30, 2009. The decrease is primarily due to lower expected remittances from the decline in delivered volumes after the expiration of a large fixed volume long term contract at the end of 2009 along with lower volumes and prices received for surplus gas sales.

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.

Other Assets

The Fund 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. Until 2009 the Fund classified certain collateral assets in the brokerage account and certain bilateral hedge instruments as other assets on the statements of net assets.

As a result of implementing GASB 53, the Fund no longer classifies hedging instruments as other assets. The hedging instruments are now classified as derivative instruments and recorded as either an asset or liability according to the provisions of GASB 53.

At June 30, 2010, other assets were valued at $92 million, and consisted of money market investments, US Treasury bills and government bonds valued at $16 million and other derivative collateral balances including margin deposits valued at $76 million. The amount decreased from a year earlier as hedge losses throughout the year lowered collateral values and money market instruments.

At June 30, 2009, other assets consist of money market investments, US Treasury bills and government bonds valued at $47 million.

Derivative Instruments - Assets

As part of implementing GASB 53, the Fund has recorded derivative instruments on the balance sheet for the years ended June 30, 2010 and 2009.

Derivative assets decreased to $25 million at June 30, 2010 from $90 million at June 30, 2009 primarily due to the Fund terminating $1,006 million notional amount of five-year constant maturity basis swaps in October 2009 combined with the decline in natural gas prices lowering the values of natural gas hedging instruments.

Deferral of derivative cash outflows decreased to $196 million at June 30, 2010 from $434 million at June 30, 2009, primarily because the Fund terminated $2,679 million notional value of interest rate swaps as part of a Series L refunding transaction in May 2010, highlighted in the Long-term debt section, as well as the lower price for natural gas decreasing the value of the deferred expenses related to natural gas hedges.

Long-Term Debt

Long-term debt decreased to $8,417 million as of June 30, 2010 from $9,001 million at June 30, 2009. Revenue bond principal payments were $518 million and $493 million in fiscal 2010 and 2009, respectively. Net amortization of bond premium and deferred loss on defeasance were $13 million and $17 million in fiscal 2010 and 2009, respectively.

To address the upcoming expiration of letters of credit in fiscal 2011 and reduce the risk and dependency from credit support providers and interest rate swap counterparties, the Fund refunded $2,679 million of variable rate bonds and terminated associated interest rate swaps as part of a Series 2010 L fixed rate refunding transaction in May 2010. As part of this refunding $970 million Series 2002 B bonds, $826 million Series 2002 C bonds, $409 Series 2005 F bonds, $213 million Series 2005 G bonds, $150 million Series 2008 I bonds and $112 million Series 2008 J bonds were refunded to fixed rate bonds. Additionally, as part of the Series L refunding transaction, the Fund refunded $430 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 $2,992 million Series L fixed rate bonds with coupons ranging from 2.0% and 5.0%. The bonds were sold with a premium of $308 million and the Fund incurred an accounting loss of $226 million which includes cost of issuance of $16 million and interest rate swap termination fees of $188 million. Such loss will be amortized over the life of the Series L bonds.

With the Series L refunding transaction in May 2010, the Fund reduced the amount of outstanding variable rate bonds to $2,005 million as of June 30, 2010, and lowered the amount of expiring credit enhancement capacity needing to be renewed by June 30, 2011 to $1,562 million.

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, the Fund renewed a letter of credit enhancing $150 million of those bonds. On December 1, 2008 the Fund successfully converted another $75 million of those variable rate bonds to fixed rate as part of a $173 million Series G conversion transaction. The Fund 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 the Fund incurred costs of issuance of $2 million, both of which will be amortized over the life of the Series G bonds.

During fiscal 2009, the Fund 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, the Fund 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 the Fund incurred costs of issuance of $2 million that will be amortized over the life of the Series F 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. Because the refunded bonds were variable rate bonds, the refunding did not result in an accounting loss.

The payment of principal and interest for all $30 million Series B bonds, $1,004 million of Series C bonds, $23 million of Series G and all $219 million Series J bonds are paid from draws made under letters of credit. The liquidity facilities backing the $343 million of Series C bonds expire in fiscal year 2013. Three liquidity facilities backing $287 million Series G bonds expire in fiscal year 2011 and the final liquidity facility underlying $100 million expires in fiscal year 2013.

The Fund is considering other options available to remedy any lack of credit capacity to renew all expiring agreements. The Fund 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. If the agreements expire or are terminated and bond market access made it impossible to refund bonds, it would result in the credit enhancing bank's required purchase of the bonds, and they become "bank bonds". The Fund is required to begin paying principal on bank bonds in quarterly installments that begin at least six months after termination. If cash on hand was insufficient to make the early principal payments, the Fund would immediately initiate a bond charge rate increase, notifying the CPUC of the increased revenue requirement for higher debt service. The CPUC has an obligation to implement bond charge rates at levels high enough to allow for the Fund's full debt service cost recovery.

Other Current Liabilities

Other current liabilities consists of Accounts payable and Accrued interest payable.

Accounts payable at June 30, 2010 is $39 million lower than at June 30, 2009. The difference results from lower power costs after the expiration of a large fixed volume long term power contract in December 2009, along with lower costs for natural gas as result of the decline in natural gas prices since the beginning of the fiscal year.

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

Accrued interest payable at June 30, 2010 is $2 million lower than at June 30, 2009 due to lower variable interest rates and $3 million higher at June 30, 2009 than at June 30, 2008 as the Fund had a higher percentage of fixed rate debt in the bond portfolio after refunding transactions in 2009 increased fixed rate debt outstanding from the prior year.

Derivative Instruments - Liabilities

As part of implementing GASB 53, the Fund has recorded derivative instruments on the balance sheet for the years ended June 30, 2010 and 2009.

Derivative liabilities decreased to $203 million at June 30, 2010 from $446 million at June 30, 2009, primarily because the Fund terminated $2,679 million notional value of interest rate swaps as part of a Series L refunding transaction in May 2010, as well as the lower price for natural gas decreasing the value of the deferred expenses related to natural gas hedges.

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):

	2010	2009	2008
Revenues:			
Power charges	$ 2,915	$ 3,310	$ 3,794
Surplus sales	108	294	529
Bond charges	864	873	868
Interest income	36	83	171
Total revenues	3,923	4,560	5,362
Expenses:			
Power purchases	2,805	3,807	4,356
Energy settlements	(62)	(30)	(32)
Interest expense	357	381	434
Investment Expense	15	110	-
Administrative expenses	37	36	34
Recovery of recoverable costs	771	256	570
Total expenses	3,923	4,560	5,362
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 the Fund to each IOU's customers.

Power Charges were $395 million lower in fiscal 2010 than in the prior year. The difference reflects the lower volume of power sales to end use customers as a result of the expiration of a large fixed volume contract in December 2009 along with lower per unit remittance rates implemented in January 2010 as part of the 2010 revenue requirement. Slightly lower volumes from falling demand across the state as a result of the softer economy also contributed.

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.

Surplus Sales

The Fund receives revenue from the sale of excess natural gas and energy from counterparties. Surplus sales of energy and natural gas for the year ended June 30, 2010 were $186 million lower than in the same period in 2009. The primary factor was the decline in volumes of surplus power sales occurring as a result of a change in remittance collection methodology adopted by the Fund and its IOU limited agents as part of implementing operational changes to adapt to the California Independent System Operator's (CAISO) Market Redesign Technology Upgrade (MRTU) launched on March 31, 2009. The Fund no longer receives a pro rata portion of surplus power sales to each IOU service area after the change. The Fund forecast this change in its 2010 revenue requirement and has implemented remittance rates to maintain required minimum balances in excess of bond indenture requirements.

Surplus sales revenues were $235 million lower in 2009 than in 2008 also as a result of the change due to the implementation of MRTU. The Fund forecasted this change in its 2009 revenue requirement and implemented remittance rates that maintained required minimum balances in excess of bond indenture requirements for the entire year.

Lower gas sales volumes and lower prices received per unit of power and gas sold also contributed to the lower amounts during 2010 and 2009 periods as commodity market prices declined sharply and have remained at lower levels.

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, 2010, 2009 and 2008 were $864 million, $873 million and $868 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. The $9 million decrease in 2010 is due to slightly lower total energy volumes sold to IOU customers as a result of the economic downturn.

Interest Income

Interest income for 2010 was $47 million lower than in 2009, due to 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 0.65% and 2.19% for the years ended June 30, 2010 and 2009, respectively.

Interest income for 2009 was $88 million lower than in 2008. The decrease was attributable to a combination of lower balances and a decline in interest earned on investments in the SMIF resulting from the lower interest rate environment.

Investment Income (Expense)

In the year ended, June 30, 2010 the Fund adopted Government Accounting Standards Board Standard No. 53 (GASB 53) which changed their accounting for commodity and hedge transactions which are determined to be derivatives. In accordance with the transition provisions of GASB 53, the change in accounting was applied retrospectively for the year ended June 30, 2009. As such financial information for fiscal 2010 and 2009 is presented in a consistent manner in both the accompanying financial statements and this management discussion and analysis (MD&A). However, fiscal 2008 financial information presented in this MD&A has not been revised.

As a result of implementing GASB 53, the Fund realizes investment income (expense) for the change in fair value of outstanding ineffective gas hedges. Due to changes in fair value of gas related hedges, the

Fund realized investment expense of $16 million and $135 million during the years ended June 30, 2010, and 2009, respectively.

During year ended June 30, 2010, the Fund elected to terminate $1,006 million notional of five-year constant maturity basis swaps, receiving $42 million in termination payments. The basis swaps were deemed ineffective and accounted for as investment hedges after adopting GASB 53. The termination resulted in the Fund realizing investment income of $1 million for 2010 after realizing $41 million for fair value changes for prior years as a result of implementing GASB 53. Realized income from expiring ineffective debt hedges has resulted in investment income of $1 million and $25 million during the years ended June 30, 2010 and 2009, respectively, and has been included in the statement of revenues, expenditures and changes in net assets.

Power Purchases

Power costs were $1,002 million lower in fiscal 2010 than in fiscal 2009. The difference is primarily a result of lower volumes purchased after the expiration of a large fixed price contract in December 2009, along with lower costs for natural gas as prices were lower for fiscal year 2010 than in fiscal 2009. Volumes purchased were also lower as demand fell from the softer economy.

Power costs were $549 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.

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 2010 were $62 million. The Fund received $21 million in proceeds from the sale of gas turbines by the City and County of San Francisco (CCSF). The turbines were originally delivered to CCSF as part of a refund settlement with Williams Energy in 2004, which also resulted in the Fund entering into a contract with CCSF to purchase power output from the turbines. Since the power plant did not become operational by the contractually agreed upon operational date, terms of the contract allowed for termination and the turbines to be sold. The Fund received $11 million as part of the FERC refund settlement agreement signed by the California Parties and the Los Angeles Department of Water & Power for overcharges during the energy crisis in 2000 and 2001. The Fund also received $11 million as part of the FERC refund settlement agreement signed by the California Parties and the Public Service Company of New Mexico related to the energy crisis in 2000 and 2001. There were additional smaller settlements with other suppliers for $19 million.

In 2009 energy settlements totaled $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.

Additionally, a tentative settlement with Sempra was negotiated in fiscal 2010 which was not recorded by the Fund since realization has not occurred. Associated revenues will be recorded when the final agreement is executed, all allocations of proceeds between the Fund and other constituents to the tentative settlement are agreed upon and any other associated contingencies are removed.

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.

Interest Expense

Interest expense was $24 million lower in 2010 when compared to 2009. The decrease is primarily due to the lower variable interest rates as rates remained at historic lows throughout the year. The lower costs from variable rate debt was partially offset by greater amounts of fixed rate debt outstanding in the portfolio as a result of the refunding transactions in 2010, 2009 and 2008.

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.

Other Expenses

Other expenses increased by $1 million in 2010 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 a decrease in amounts for postretirement health and dental liabilities incurred by the Fund.

Recovery (Deferral) of Recoverable Costs

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

	2010	2009	2008
Operations	$ 227	$ (344)	$ (35)
Debt service and related costs	544	600	605
	$ 771	$ 256	$ 570

Operations
The $227 million recovery in the year ended June 30, 2010 reflects the collection of higher remittances than necessary to pay power costs due to the lower than projected prices for natural gas.

The $344 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. The recovery in 2010 was lower due to non-operating expenditures offsetting debt related recovery as a result of implementing GASB 53.

LIQUIDITY

With the Series L refunding transaction in May 2010, the Fund reduced the amount of outstanding variable rate bonds to $2,005 million, and lowered the amount of expiring credit enhancement capacity that needed to be renewed by June 30, 2011 to $1,562 million.

Subsequent to June 30, 2010, the Fund executed a Series 2010M refunding transaction that included refunding variable rate bonds, lowering the amount of variable rate bonds outstanding to $948 million and the amount of credit enhancement capacity expiring by June 30, 2011 to $605 million. The amounts for renewal in fiscal 2011 include facilities backing $25 million Series B bonds and $580 million Series C bonds.

The Fund has the option to allow bonds with required credit support to convert to bank bonds when credit support expires. While this would substantially mitigate any near term liquidity issues, the Fund does not plan to pursue this course of action because of the higher interest costs associated with bank bonds and other factors.

If the agreements expire or are terminated and bond market access made it impossible to refund bonds, it would result in the credit enhancing bank's required purchase of the bonds, and they become “bank bonds”. The Fund is required to begin paying principal on bank bonds in quarterly installments that begin at least six months after termination. If cash on hand was insufficient to make the early principal payments, the Fund would immediately initiate a bond charge rate increase, notifying the CPUC of the increased revenue requirement for higher debt service. While subject to administrative process, the CPUC has an obligation to implement bond charge rates at levels high enough to allow for the Fund's full debt service cost recovery.

The Fund started a Request for Proposal (RFP) process, asking for pricing and terms from financial institutions for credit enhancement facilities to renew or replace the existing agreements that are expiring by June 30, 2011. If pricing proposals are at levels that make it uneconomic to renew all or part of the remaining $605 million expiring, the Fund may consider alternatives including additional fixed refunding transactions or refunding the bonds with a variable rate product not requiring credit enhancement.

The remaining $343 million of credit facilities which back Series C bonds, expire in fiscal year 2013.

Department of Water Resources Electric Power Fund
Statements of Net Assets
June 30, 2010 and 2009 (in millions)

	2010	2009 (As Restated)
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 549	$ 543
Debt Service Reserve Account	941	950
Derivative instruments	6	57
Deferral of derivative cash outflows	112	258
Recoverable costs	4,881	5,653
Total long-term assets	6,489	7,461
Current assets:		
Restricted cash and equivalents:		
Operating and Priority Contract Accounts	1,257	964
Bond Charge Collection and Bond Charge Payment Accounts	630	629
Recoverable costs, current portion	339	468
Interest receivable	7	13
Derivative instruments, current portion	19	33
Deferral of derivative cash outflows, current portion	83	176
Other assets	92	47
Total current assets	2,427	2,330
Total assets	$ 8,916	$ 9,791
Capitalization and Liabilities		
Capitalization:		
Net assets	$ -	$ -
Long-term debt	7,878	8,471
Non-Current liabilities:		
Derivative instruments	114	262
Deferral of derivative cash inflows	2	2
Total capitalization and non-current liabilities	7,994	8,735
Current liabilities:		
Current portion of long-term debt	539	530
Derivative instruments, current portion	89	184
Deferral of derivative cash inflows, current portion	6	13
Accounts payable	227	266
Accrued interest payable	61	63
Total current liabilities	922	1,056
Commitments and Contingencies (Note 7)		
Total capitalization and liabilities	$ 8,916	$ 9,791

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, 2010 and 2009 (in millons)

	2010	2009 (As Restated)
Operating revenues:		
Power charges	$ 2,915	$ 3,310
Surplus sales	108	294
Total operating revenues	3,023	3,604
Operating expenses:		
Power purchases	2,805	3,807
Energy settlements	(62)	(30)
Administrative expenses	37	36
Recovery (deferral) of recoverable operating costs	227	(344)
Total operating expenses	3,007	3,469
Income from operations	16	135
Bond charges	864	873
Interest income	36	83
Interest expense	(357)	(381)
Investment income from debt related derivatives	1	25
Investment income (expense) from gas related derivatives	(16)	(135)
Recovery of recoverable debt service and related costs	(544)	(600)
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, 2010 and 2009 (in millions)

		2010		2009 (As Restated)
Cash flows from operating activities:				
Receipts:				
Power charges	$	3,056	$	3,277
Surplus sales		109		368
Energy settlements		48		30
Payments for power purchases and other expenses		(2,925)		(4,033)
Net cash provided by (used in) operating activities		288		(358)
Cash flows from non-capital financing activities:				
Receipt of bond charges		866		875
Bond payments		(518)		(493)
Interest payments		(373)		(399)
Proceeds from issuance of revenue bonds		3,300		529
Defeasance of revenue bonds		(3,353)		(523)
Net cash used in non-capital financing activities		(78)		(11)
Cash flows from investing activities:				
Interest received on investments		42		97
Income received from derivative investments		39		47
Proceeds from termination of guaranteed investment contract		-		150
Net cash provided by investing activities		81		294
Net increase (decrease) in cash and equivalents		291		(75)
Restricted cash and equivalents, beginning of year		2,786		2,861
Restricted cash and equivalents, end of year	$	3,077	$	2,786
Restricted cash and equivalents included in:				
Operating Reserve Account	$	549	$	543
Debt Service Reserve Account (a component of the total of $941 and $950 at June 30, 2010 and 2009, respectively)		641		650
Operating and Priority Contract Accounts		1,257		964
Bond Charge Collection and Bond Charge Payment Accounts		630		629
Restricted cash and equivalents, end of year	$	3,077	$	2,786
Reconciliation of operating income to net cash provided by (used in) operating activities:				
Income from operations	$	16	$	135
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:				
Recovery (deferral) of recoverable operating costs		227		(344)
Changes in net assets and liabilities:				
Recoverable costs		129		(154)
Other assets		(45)		214
Accounts payable		(39)		(209)
Net change in operating assets & liabilities:		45		(149)
Net cash provided by (used in) operating activities	$	288	$	(358)

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).

The Fund purchases power from wholesale suppliers under contracts entered into prior to January 1, 2003 for resale to 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 the Fund from entering into new power purchase agreements, but allows the Fund to enter into gas purchase contracts to provide fuel for power generation.

The Fund power is delivered to the customers through the transmission and distribution systems of the IOUs and payments from the customers are collected for the Fund 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 the Fund and the CPUC, the CPUC implements the Fund's determination of its revenue requirements by establishing customer rates that meet the Fund'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, 2010 and 2009, 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.

Change in Accounting Principle

Governmental Accounting Standards Board Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (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. In accordance with the transition provisions of GASB 53, the Fund adopted the standard in fiscal year 2010 with restatement of previously reported financial statement amounts at June 30, 2009 and for the year then ended to reflect retroactive application of the new standard.

The Fund is party to derivative financial instruments, consisting of interest rate swap agreements, gas price swap agreements, gas option agreements, and gas and electricity purchase agreements. Under the provisions of GASB 53, derivatives that are not excluded under normal purchases or normal sales are recorded at fair value on the statements of net assets. 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 the Fund will take delivery of the commodity specified in the derivative instrument. Accordingly, most of the Fund's gas purchase agreements, and most of its electric purchase agreements, are excluded from the scope of GASB 53.

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. The Fund has included the fair values of all derivatives on the statements of net assets as assets or liabilities. The Fund reports derivative financial instruments with remaining maturities of one year or less as current, and those with maturities of greater than one year as long term on the statements of net assets. Derivatives that meet the definition of effective hedges as set forth in GASB 53 are treated as hedge transactions which result in the recognition of corresponding deferred derivative inflows and outflows in the statements of net assets. Changes in the fair value of derivatives that do not meet the requirements of an effective hedge transaction are included in investment income (expense) in the statement of revenues, expenses and changes in net assets.

A summary of the fiscal year 2009 financial statement items restated in connection with the adoption of GASB 53 is shown in the following tables:

Statement of Net Assets
(in millions)

	Balance previously reported at June 30, 2009	GASB 53 adjustment	June 30, 2009 (As Restated)
Assets			
Long-term assets:			
Derivative instruments	$ -	$ 57	$ 57
Deferral of derivative cash outflows	-	258	258
Recoverable costs, net of current portion	5,691	(38)	5,653
Current assets:			
Derivative instruments, current maturities	-	33	33
Deferral of derivative cash outflows, current portion	-	176	176
Other assets	72	(25)	47
Capitalization and Liabilities			
Non-current liabilities:			
Derivative instruments	-	262	262
Deferral of derivative cash inflows	-	2	2
Current liabilities:			
Derivative instruments, current maturities	-	184	184
Deferral of derivative cash inflows, current portion	-	13	13

Statement of Revenues, Expenses and Changes in Net Assets

(in millions)

	Balance previously reported at June 30, 2009	GASB 53 adjustment	June 30, 2009 (As Restated)
Power purchases	$ 3,930	$ (123)	$ 3,807
Recovery (deferral) of recoverable operating costs	(332)	(12)	(344)
Operating income	-	135	135
Investment income from debt related derivatives	-	25	25
Investment income (expense) from gas related derivatives	-	(135)	(135)
Recovery of recoverable debt service and related costs	(575)	(25)	(600)

Statement of Cash Flows
(in millions)

	Balance previously reported at June 30, 2009	GASB 53 adjustment	June 30, 2009 (As Restated)
Payments for power purchases and other expenses	$ (3,986)	$ (47)	$ (4,033)
Income (Expense) received from derivative instruments	-	47	47
Income from operations	-	135	135
Recovery (deferral) of recoverable operating costs	(332)	(12)	(344)
Recoverable costs	41	(195)	(154)
Other Assets	189	25	214

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. Collateral values, net trade equity and reserve investments held in a brokerage account are accounted for as other assets on the balance sheet. 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 are carried at fair value. At June 30, 2010, other assets were valued at $92 million, and consisted of money market investments valued at $16 million and other collateral balances valued at $76 million. At June 30, 2009, other assets consist of money market investments, US Treasury bills and government bonds valued at $47 million.

Revenues and Recoverable Costs
The Fund 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 the Fund 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 the Fund 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 the Fund, the IOU, or an ESP, is delivered to IOU or ESP customers. Costs are recovered over the life of the bonds as determined by the Fund's revenue requirement process.

Surplus sales represent the Fund's 1) 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 the Fund and the IOUs, based on the amount of energy provided by the Fund 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 and surplus energy dispatched by the CAISO from the Fund's power purchase agreements for grid reliability are still received.

3. Restricted Cash and Investments

The State of California has a deposit policy to address custodial credit risk. As of June 30, 2010 and 2009, $4 million and $6 million, respectively, of the Fund's cash balances were uninsured and uncollateralized.

As of June 30, 2010 and 2009, the Fund had the following cash, cash equivalents and investments (in millions):

Investment	Maturity	2010	2009
State of California Pooled Money Investment Account - State Money Investment Fund	6.7 months average	$ 3,065	$ 2,752
Cash		12	34
Total cash and equivalents		3,077	2,786
Guaranteed investment contracts	May 1, 2022	200	200
Forward purchase agreement	November 1, 2010	100	100
		$ 3,377	$ 3,086
Reconciliation to Statement of Net Assets:			
Operating Reserve Account		$ 549	$ 543
Debt Service Reserve Account		941	950
Operating and Priority Contract Accounts		1,257	964
Bond Charge Collection and Bond Charge Payment Accounts		630	629
		$ 3,377	$ 3,086

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, 2010 (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	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 0.6% and 1.4% at June 30, 2010 and 2009, respectively. For the years ended June 30, 2010 and 2009, interest earned on the deposit in the PMIA was $21 million and $61 million, respectively.

Interest on the GICs is paid semi-annually at interest rates ranging from 5.3% to 5.5%. Interest earned on the GICs was $11 million and $17 million for the years ended June 30, 2010 and 2009, respectively. In 2009, a GIC valued at $150 million was redeemed and the proceeds were invested in SMIF.

The FPA allows the Fund 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, 2010 and 2009.

4. Long-Term Debt

The following activity occurred in the long-term debt accounts during the years ended June 30, 2010 and 2009 (in millions):

	Revenue Bonds	Unamortized Premium	Deferred Loss on Defeasance	Total
Balance, June 30, 2008	$ 9,525	$ 166	$ (182)	$ 9,509
Refunding				
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
Refunding				
Issuance of debt	2,992	308	-	3,300
Defeasance of debt	(3,109)	(18)	(226)	(3,353)
Payments	(518)	-	-	(518)
Amortization	-	(34)	21	(13)
Balance, June 30, 2010	8,395	398	(376)	8,417
Less current portion	526	66	(53)	539
	$ 7,869	$ 332	$ (323)	$ 7,878

Long-term debt consists of the following at June 30, 2010 and 2009, respectively (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding 2010		Amount Outstanding 2009	
A	Fixed (3.6-6.0%)	2018	2012	$	1,590	$	2,458
B	Variable	2020	Callable		30		1,000
C	Variable	2021	Callable		1,346		2,229
F	Variable		Callable		-		409
F	Fixed (4.38-5.0%)	2022	Callable		348		348
G	Variable	2016	Callable		410		646
G	Fixed (4.35-5.0%)	2018	Callable		173		173
H	Fixed (3.75-5.0%)	2022	2018		1,007		1,007
I	Variable		Callable		-		150
J	Variable	2015	Callable		219		330
K	Fixed (4.0-5.0%)	2018	Non-callable		279		279
L	Fixed (2.0-5.0%)	2022	2020		2,993		-
				$	8,395	$	9,030
Plus unamortized bond premium					398		142
Less deferred loss on defeasance					(376)		(171)
Less current maturities					(539)		(530)
				$	7,878	$	8,471

Bond refunding transactions

To address the upcoming expiration of letters of credit in fiscal 2011 and reduce the risk and dependency from credit support providers and interest rate swap counterparties, the Fund refunded $2,679 million of variable rate bonds and terminated associated interest rate swaps as part of a Series 2010 L fixed rate refunding transaction in May 2010. As part of this refunding $970 million Series 2002 B bonds, $826 million Series 2002 C bonds, $409 Series 2005 F bonds, $213 million Series 2005 G bonds, $150 million Series 2008 I bonds and $112 million Series 2008 J bonds were refunded and refinanced with fixed rate bonds. Additionally, as part of the Series L refunding transaction, the Fund refunded $430 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 $2,992 million Series L fixed rate bonds with coupons ranging from 2.0% and 5.0%. The bonds were sold with a premium of $308 million and the Fund incurred an accounting loss of $226 million which includes cost of issuance of $16 million and interest rate swap termination fees of $188 million. Such amounts will be amortized over the life of the Series L bonds.

With the Series L refunding transaction in May 2010, the Fund reduced the amount of outstanding variable rate bonds to $2,005 million, and lowered the amount of expiring credit enhancement capacity needing to be renewed by June 30, 2011 to $1,562 million.

During the year-ended June 30, 2009, the Fund 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, the Fund converted $173 million of Series G variable-rate bonds to fixed rate bonds.

In January 2009, the Fund 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 Series F 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%. All other callable bonds are redeemable at 100%.

The Fund'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 2011 to 2022. The interest rates for the variable debt for the year ended June 30, 2010 and 2009, ranged from 0.02% to 2.50% and from 0.05% to 10.00%, respectively.

The payment of principal and interest for all $30 million Series B bonds, $1,004 million of Series C bonds, $23 million of Series G and all $219 million Series 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 quarterly 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, 2010. The Fund pays fees of 0.35% per annum on the stated amount of the letters of credit for the Series B and C bonds, and 0.28% per annum on the stated amount for the Series G bonds, and 0.53% per annum on the stated amount for the Series J bonds. As of June 30, 2010, all Series B, C, G, and J letters of credit expire in fiscal year 2011.

Remarketing, credit support and related uncertainties
The Fund bonds are remarketed by fourteen different broker-dealer remarketing agents, with credit enhancement provided by sixteen 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. Early repayment requirements vary with each type of credit facility. Letters of credit require the Fund 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.

In the past, 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, 2010, there were no outstanding bank bonds.

After the Series L refunding transaction, at June 30, 2010, $343 million of Series C bonds and $387 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, 2010. 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 June 30, 2010. The liquidity facilities backing the $343 million of Series C bonds expire in fiscal year 2013. Liquidity facilities backing $287 million of Series G bonds expire in fiscal year 2011 and the remaining liquidity facility underlying $100 million expires in fiscal year 2013. The Fund pays fees of 0.37% per annum under all liquidity facilities.

Maturities

As of June 30, 2010, there were letters of credit and liquidity facilities enhancing $1,562 million of variable rate bonds that expire before June 30, 2011. The Fund has begun the renewal process for those agreements and expects to execute renewal agreements prior to the expiration of the existing letters of credit.

If the letters of credit are not renewed, the bonds would become bank bonds which would command higher interest rates and would be subject to an accelerated amortization schedule. If this were to occur, the Fund's current portion of debt service would increase by $132 million for 2011, and would increase by $524 million annually for 2012 and 2013, and $292 million, $60 million and $30 million for 2014, 2015 and 2016, respectively until fully repaid. Interest costs on the bank bonds may also be higher than rates attainable from variable reset rates. If cash on hand was insufficient to make the early principal payments, the Fund would immediately initiate a bond charge rate increase, notifying the CPUC of the increased revenue requirement for higher debt service. While subject to administrative process, the CPUC has an obligation to implement bond charge rates at levels high enough to allow for the Fund's full debt service cost recovery.

Subsequent to June 30, 2010, the Fund executed a Series 2010M refunding transaction that included refunding variable rate bonds, lowering the amount of letters of credit facilities expiring to $605 million in fiscal 2011. The remaining amounts for renewal in fiscal 2011 include facilities backing $25 million Series B bonds and $580 million Series C bonds. The Fund started a Request for Proposal (RFP) process asking for pricing and terms from financial institutions for credit enhancement facilities to renew or replace the existing agreements that are expiring by June 30, 2011. If pricing proposals are at levels that make it uneconomic to renew all or part of the remaining $605 million expiring, the Fund may consider alternatives including additional fixed refunding transactions or refunding the bonds with a variable rate product not requiring credit enhancement.

Future payment requirements on the revenue bonds are as follows at June 30, 2010 (in millions):

Fiscal Year	Principal	Interest [1]	Total
2011	$ 525	$ 319	$ 844
2012	550	300	850
2013	602	273	875
2014	612	243	855
2015	641	215	856
2016-2020	3,713	739	4,452
2021-2022	1,752	107	1,859
	$ 8,395	$ 2,196	$ 10,591

[1] Variable portion of interest cost calculated using the June 30, 2010 Securities Industry and Financial Markets Association Swap Index (SIFMA)

5. Derivative Financial Instruments

As described in Note 2, the Fund implemented GASB 53 during the year ended June 30, 2010. 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. This accounting is applied retrospectively to fiscal year ending June 30, 2009. 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 statements of net assets as of June 30, 2010 and 2009.

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 the Fund. The Fund has agreed to make fixed rate payments and receive floating rate payments on notional amounts equal to a portion of the principal amount of the Fund's variable rate debt.
The fair values, classification and notional amounts outstanding for the Fund's natural gas hedge derivatives and interest rate swaps accounted for as derivative financial instruments at June 30, 2010 and 2009 are summarized in the following table:

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)	

As of June 30, 2009

	Business-type activities		Value	Notional
Effective hedges				
Assets				
Current	Gas Swaps	$	13.0	36,867,500 MMBtu
Long Term	Gas Swaps		2.0	8,417,500 MMBtu
		$	15.0	
Liabilities				
Current	Gas Swaps	$	(175.8)	83,312,000 MMBtu
Long Term	Gas Swaps		(32.2)	31,375,000 MMBtu
Long Term	Interest Rate Swaps		(225.8)	$3,812,100,000
		$	(433.8)	
Investment hedges				
Assets				
Current	Gas Swaps	$	0.4	3,355,000 MMBtu
Current	Gas Options		20.4	109,399,118 MMBtu
Long Term	Gas Swaps		0.3	3,525,000 MMBtu
Long Term	Gas Options		14.0	25,275,901 MMBtu
Long Term	Interest Rate Swaps		41.0	$1,006,400,000
		$	76.1	
Liabilities				
Current	Gas Swaps	$	(1.7)	6,030,000 MMBtu
Current	Gas Options		(6.5)	72,209,999 MMBtu
Long Term	Gas Swaps		(0.9)	4,587,500 MMBtu
Long Term	Gas Options		(2.6)	9,379,999 MMBtu
		$	(11.7)	

All effective and ineffective hedges in asset and liability positions are included within the tables above and have been recorded in the statements of net assets as derivative instruments. Changes in fair value for effective hedges are recorded in the statement of net assets as deferred cash inflows or outflows.

Changes in fair value for ineffective gas hedges are recorded as investment expense from gas related contracts on the statement of revenues, expenses and changes in net assets. Between fiscal 2010 and 2009 there was a $16 million decrease in the fair value of ineffective gas hedges.

Changes in fair value for ineffective interest rate swaps are recorded as investment expense from debt related contracts on the statement of revenues, expenses and changes in net assets. Between fiscal 2010 and 2009 there was a $1 million decrease in the fair value of ineffective interest rate swaps.

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 under 12 months remaining until expiration, or as long-term assets or liabilities for contracts with over 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.

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 June 30, 2010 are with ten different counterparties, all of which have credit ratings of at least A-/Baa1. At June 30, 2010, the Fund has credit risk exposure to three counterparties totaling $3 million, representing transactions with market values that are in the Fund's favor. There is no substantial credit exposure to the remaining seven counterparties, as the sharp decrease of natural gas prices has 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

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

As of June 30, 2010, all of the Fund's interest rate swaps are considered effective hedging derivatives under GASB 53, have been recorded at fair value on the statements of net assets as long-term assets or liabilities.

The terms, fair values, and credit ratings of counterparties for the various swap agreements at June 30, 2010 are summarized in the following table (in millions):

Outstanding Notional Amount	Fixed Rate Paid by Fund	Variable Rate [1] Received by Fund	Fair Value	Swap Termination Date	Counterparty Credit Rating S&P	Moody's	Fitch
$ 92	3.405%	SIFMA	$ (3)	May 1, 2013	A+	Aa3	AA-
46	3.405%	SIFMA	(2)	May 1, 2013	A	A2	A
14	3.405%	SIFMA	(1)	May 1, 2013	A	A2	A+
242	3.184%	66.5% of LIBOR	(19)	May 1, 2015	BBB	A3	A-
174	3.280%	67% of LIBOR	(17)	May 1, 2015	NR	A1	A+
485	3.228%	66.5% of LIBOR	(50)	May 1, 2016	AA	Aa2	AA-
$ 1,053			$ (92)				

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

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, 2010, the variable rates on the Fund's hedged bonds ranged from 0.02% to 2.5%, while the variable rates received on the LIBOR-based swaps were 0.15% to 0.24% and the variable rate received on the SIFMA-based swaps was 0.15% to 0.43%.

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 the Fund's floating interest payments payable on the underlying debt are determined in the tax-exempt market, while the Fund'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 the Fund's bonds trade at levels higher in rate in relation to the tax-exempt market, the Fund's all-in costs would increase.

Net amounts paid under all swaps amounted to $98 million and $75 million for the years ended June 30, 2010 and 2009, respectively.

Credit Risk: The Fund has a total of six swap agreements with six different counterparties at June 30, 2010. As depicted in the table above, credit ratings of the counterparties range from BBB to AA-, except for one counterparty that is not rated.

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, the Fund 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.

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 limited 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, 2010, 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**
2011	$ 148	$ 3	$ 31	$ 182
2012	45	3	27	75
2013	34	3	26	63
2014	27	3	25	55
2015	315	2	22	339
2016-2020	485	1	12	498
	$ 1,054	$ 15	$ 143	$ 1,212

Termination of Interest Rate Swaps

During the year ended June 30, 2010, the Fund elected to terminate $1,006 million notional of five-year constant maturity basis interest rate swaps, receiving $42 million in termination payments. The basis swaps were deemed ineffective and accounted for as investment hedges after adopting GASB 53. The termination resulted in the Fund realizing investment income of $1 million for 2010, representing the net increase in fair value of these swaps during fiscal year 2010 prior to their termination.

As part of the Series L refunding transaction in May 2010, the Fund terminated $2,679 million notional of LIBOR-based interest rate swaps. The Fund incurred $188 million in swap termination costs, which will be amortized over the life of the Series L bonds.

There were no interest rate swaps terminated in 2009.

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. The Fund is included in the State Miscellaneous Category (Tier 1 and Tier 2) within PERS, thereby limiting the availability of certain Fund 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 the Fund, 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, 2010 and 2009, the Fund'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 $1.0 million for the years ended June 30, 2010 and 2009, respectively. During fiscal year 2009, the Fund modified its allocation method of post-retirement health care costs between DWR funds. The allocation method is now based on labor costs. The Fund's net OPEB obligation increased by $0.7 million at June 30, 2010 to $2.2 million, from $1.5 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, 2010. The State's unfunded actuarial accrued liability at July 1, 2009 attributable to all State employees is projected to be $51,000 million.

7. 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 $3,500 million in refunds associated with the Fund's approximately $5,000 million 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 $5,000 million in short term bilateral purchases, $2,900 million 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 June 30, 2010, none of the Fund's power purchase contracts have been replaced.

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 the Fund's revenue requirement.

Commitments
The Fund has power purchase contracts that have remaining lives of up to seven years. Payments under these and gas purchase contracts approximated $2,805 million and $3,807 million for fiscal 2010 and 2009, respectively.

The remaining amounts of fixed obligations under the contracts as of June 30, 2010, are as follows (in millions):

Fiscal Year	**Fixed Obligation**
2011	$ 1,467
2012	637
2013	62
2014	15
2015	4
Thereafter	1
	$ 2,186

In addition to the fixed costs there are variable costs under several of the contracts. Management projected as of June 30, 2010 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $3,771 million. 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.

All of the power and gas purchase contracts qualify under the normal purchases and normal sales exclusion under the provisions of GASB 53 since it is probable that the Fund will take delivery of the commodity, and the Fund uses the commodity in its operations as in the normal course of business. As a result, market valuation and certain risk information are not required to be disclosed.

8. 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 fiscal year 2010, the Fund received $62 million in energy settlements. The Fund received $21 million in proceeds from the sale of gas turbines by the City and County of San Francisco (CCSF). The turbines were originally delivered to CCSF as part of a refund settlement with Williams Energy in 2004, which also resulted in the Fund entering into a contract with CCSF to purchase power output from the turbines. Since the power plant did not become operational by the contractually agreed upon operational date, terms of the contract allowed for termination and the turbines to be sold.

Additionally, the Fund received $11 million as part of the FERC refund settlement agreement signed by the California Parties and the Los Angeles Department of Water & Power for overcharges during the energy crisis in 2000 and 2001. The Fund also received $11 million as part of the FERC refund settlement agreement signed by the California Parties and the Public Service Company of New Mexico related to the energy crisis in 2000 and 2001. There were additional smaller settlements with other suppliers for $19 million.

On April 28, 2010, the CPUC issued a press release to the effect that an agreement in principle had been reached to settle various claims involving Sempra and relating to the California energy crisis of 2000 and 2001. Under the terms of the proposed settlement in exchange for a cash payment by Sempra of approximately $410 million and certain other consideration, Sempra and certain of its affiliates will exchange mutual releases with the Fund, 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 will cover all claims related to the long term power purchase agreement between the Fund and Sempra, and 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 the Fund 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. The $410 million cash settlement amount will be allocated as determined by the Settling Parties. As of June 30, 2010 final settlement terms and allocations were still being negotiated, and as such realization of this settlement has not occurred and it is not reflected in these financial statements. In October 2010, the settlement was finalized and sent to FERC for approval. To date, the settlement is still awaiting FERC approval and no monies have been distributed.

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.

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.

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 $63 million and expires on November 30, 2010. The total commitment for the two letters of credit underlying the PERS' participation approximates $54 million and expires on April 15, 2011. There are no outstanding amounts on the letters of credit at June 30, 2010 or 2009.