Department of Water Resources
Electric Power Fund
Financial Statements

September 30, 2012

Department of Water Resources Electric Power Fund
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USING THIS REPORT

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

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

PURPOSE OF FUND

The Fund was established in January 2001 through legislation to assist mitigation of the effects of a statewide energy supply emergency.

DWR has the authority to secure and retain title to power for resale to end use customers of the State's investor owned utilities (IOUs) under power supply contracts entered into prior to January 1, 2003. The scheduling, dispatch, and certain other administrative functions for the long-term contracts are performed by the IOUs as agents for DWR. However, DWR retains the legal and financial responsibility for each contract for the life of the contract or until such time as there is complete assignment of the contract to an IOU and release of DWR. Most of the volume of power under contract expired by June 30, 2012 and the last of the contracts expires in fiscal 2016.

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

This report should be read in conjunction with the Fund's June 30, 2012 audited financial statements.

STATEMENTS OF NET ASSETS

The Fund's assets, liabilities and net assets as of September 30, 2012 and June 30, 2012 are summarized as follows (in millions):

	September 30, 2012		June 30, 2012	
Long-term restricted cash, equivalents and investments	$	987	$	1,186
Recoverable costs		5,056		5,038
Derivative instruments		-		-
Deferral of derivative cash outflows		2		2
Restricted cash and equivalents:				
Operating and priority contract accounts		383		398
Bond charge collection and bond charge payment accounts		823		582
Recoverable costs, current portion		111		131
Interest receivable		10		4
Other assets		43		45
Total assets	$	7,415	$	7,386
Net assets	$	-	$	-
Long-term debt, including current portion		7,255		7,259
Derivative instruments		4		7
Deferral of derivative cash inflows		-		-
Other current liabilities		156		120
Total capital and liabilities	$	7,415	$	7,386

Long-Term Restricted Cash and Investments

The Operating Reserve Account decreased to $68 million at September 30, 2012 from $267 million at June 30, 2012. The amount is determined in accordance with the Master Trust Indenture (the Indenture) and is equal to the maximum of one month priority contract cost amount under stress conditions for the calendar year 2012 as forecasted in DWR's 2012 revenue requirement determination. The balance of the Debt Service Reserve Account remains at $919 million, and was also determined in accordance with the requirements of the Indenture.

Recoverable Costs, Net of Current Portion

Long-term recoverable costs consist of costs that are recoverable through future billings. The $18 million net increase in long-term recoverable costs during the three month period ended September 30, 2012 is the net of 1) operating expenses exceeding operating revenues by $199 million, as power charges were lower due to lower remittance rates and the return of reserves to the IOUs, 2) bond charge revenue exceeding interest expense by $178 million and 3) a $3 million change in the unrealized gain on open and ineffective natural gas futures contracts at period end.

Restricted Cash and Investments

The Operating and Priority Contract Accounts decreased by $15 million during the three month period ended September 30, 2012. DWR purposefully reduced cash balances while staying within the requirements of the Indenture as part of a planned return of cash reserves to ratepayers through lower power charge rates.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $241 million in the period ended September 30, 2012 in anticipation of the semi-annual interest payment on fixed rate bonds due on November 1, 2012, with the next principal and interest payment due May 1, 2013.

From the dates of issuance of the revenue bonds through September 30, 2012, the balances in each of the restricted cash and investments accounts met or exceeded balances required by the Indenture.

Recoverable Costs, Current Portion

The current portion of recoverable costs reflects billings to IOU customers that have not yet been collected and amounts due for surplus sales of energy and gas. The current portion of recoverable costs is $111 million at September 30, 2012, decreasing from $131 million at June 30, 2012. The lower amounts are as a result of lower volumes of power sold to end use customers as the power purchases decline with the expiration of several contracts.

Other Assets

DWR purchases natural gas as fuel for the production of power under the terms of certain power purchase contracts and maintains a brokerage account with a national brokerage firm in order to hedge natural gas costs. DWR invests funds to be used to meet realized losses as they occur, provide collateral for current positions, and enable future hedging activities that require margin or immediate payment. Assets in this account are classified as other assets on the Statements of Net Assets. At September 30, 2012, other assets consisted of money market obligations, US Treasury bills, and government bonds valued at $43 million.

Derivative Instruments-Assets

DWR is party to natural gas hedging positions that are considered to be derivatives under the provisions of GASB 53 and included on the statement of net assets for periods ended September 30, 2012 and June 30, 2012.

There were no derivative financial instrument assets at September 30, 2012 and June 30, 2012. DWR is no longer purchasing new natural gas futures contracts and all remaining natural gas futures contracts have unrealized losses.

Deferred outflows were unchanged at $2 million at September 30, 2012 and June 30, 2012 as the lower volume of natural gas futures contracts was offset by higher natural gas futures prices.

Long-Term Debt

Long-term debt decreased to $7,255 million as of September 30, 2012 from $7,259 million at June 30, 2012. The decrease is attributable to the net of amortization of premium, deferred loss on defeasance and deferred cost of issuance.

Other Current Liabilities

Accounts payable reflect one month's accrual for power and fuel purchases, as payments are normally made on the 20th of the month following purchase. At September 30, 2012 accounts payable are $49 million lower than at June 30, 2012 as contract volumes decreased due to expiration of purchase power contracts.

Accrued interest payable increased to $142 million at September 30, 2012 from $57 million at June 30, 2012 in anticipation of the next interest payment date on November 1, 2012.

Derivative Instruments- Liabilities

DWR is party to natural gas hedging positions that are considered to be derivatives under the provisions of GASB 53 and included on the statement of net assets for the periods ended September 30, 2012 and June 30, 2012.

Derivative financial instrument liabilities decreased $3 million, and were valued at $4 million and $7 million at September 30, 2012 and June 30, 2012, respectively. These liabilities decreased as existing natural gas futures contracts expired and no new contracts were purchased. Also, rising natural gas futures prices reduced the unrealized loss on the remaining natural gas futures.

There were no deferred inflows at September 30, 2012 or at June 30, 2012, as few open derivative financial instrument assets remain.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Fund's activities for the three months ended September 30, 2012 and 2011 are summarized as follows (in millions):

	2012	2011
Revenues:		
Power charges	$ (183)	$ 196
Surplus sales	-	11
Bond charges	252	230
Interest income	7	6
Total revenues	76	443
Expenses:		
Power purchases	12	469
Energy settlements	-	(10)
Interest expense	81	81
Investment Expense	-	(1)
Administrative expenses	4	6
Recovery of recoverable costs	(21)	(102)
Total expenses	76	443
Net increase in net assets	-	-
Net assets, beginning of year	-	-
Net assets, end of year	$ -	$ -

Power Charges

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

Power charges decreased by $379 million in the three months ended September 30, 2012 compared to the same three month period in 2011. The difference reflects a combination of lower volume of power sales to end use customers with the expiration of long term power purchase contracts and the return of excess amounts and previously received remittances to ratepayers in the Pacific Gas and Electric Company (PG&E) and Southern California Edison (SCE) service territories.

The return of excess amounts and previously received remittances are an allocation of prior year over-collections from ratepayers and reserves in excess of Indenture required levels. During the first three months of fiscal 2013, DWR returned $195 million to ratepayers and will return a total of $390 million during the first six months of fiscal year 2013. This allocation of prior year over-collections and excess reserves was authorized by the CPUC in Decision 11-12-005. It is anticipated that DWR will continue the return of excess amounts and previously received remittances to ratepayers in PG&E's and SCE's service territories during calendar year 2013. Amounts will be determined as part of DWR's annual 2013 Revenue Requirement Determination.

In first three months of fiscal 2012, DWR returned $121 million in excess amounts and previously received remittances to PG&E ratepayers in separate monthly payments. This allocation of prior year over-collections and excess reserves was authorized by the CPUC in Decision 10-12-006.

Surplus Sales

Surplus sales of energy and natural gas in the three month period ended September 30, 2012 were $11 million lower than in the same period in 2011. The primary factors were a decrease in volumes of surplus power sales from power plant dispatches by the California Independent System Operator's (CAISO) and lower natural gas sales revenue due to lower volumes and prices.

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 three months ended September 30, 2012 are $22 million higher than the same period in 2011 due to higher delivered volumes and slightly higher bond charge remittance rates. The amount collected is adequate to meet all debt service requirements and maintain Indenture required account balances in the Bond Charge Collection, Bond Charge Payment, and Debt Service Reserve Accounts.

Interest Income

Interest income of $7 million for the three months ended September 30, 2012 is $1 million higher than for the same period in 2011. The increase is as a result of an increase in interest earned on investments in the State of California Investment Pooled Money Investment Account-Surplus Investment Fund (SMIF).

Power Purchases

Power costs are $457 million lower in the three months ended September 30, 2012 than in the same period in 2011. The decrease in costs is primarily due to the expiration of all but three power purchase contracts in fiscal 2012 and lower prices for natural gas in the first three months of fiscal 2013 when compared to fiscal 2012.

Energy Settlements

In the quarter ended September 30, 2012, there were no revenues received from energy settlements.

In the quarter ended September 30, 2011, the Fund received $10 million in energy settlements. The Fund received $6 million as part of the FERC refund settlement agreement signed by the California Parties (CPUC, the State Attorney General, California Department of Water Resources acting through the Fund, Southern California Edison Company, San Diego Gas and Electric Company, and Pacific Gas and Electric Company) and the City of Pasadena. The Fund also received $3 million from the Modesto Irrigation District ("MID") as part of the FERC refund settlement agreement signed by the California Parties and MID. Lesser amounts were received from FERC refund settlement agreements with the cities of Santa Clara, Seattle, Glendale, and Burbank, PPL Montana and the Turlock Irrigation District.

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

Interest Expense

Interest expense in the three months ended September 30, 2012 is unchanged from the same period in 2011.

Investment Expense

There were no changes in the fair value of natural gas futures contracts and the Fund realized no investment expenses from expiring ineffective natural gas futures contracts for the period ended September 30, 2012.

Other Expenses

Other expenses in the three months ended September 30, 2012 were $2 million lower than the same period in 2011, as a result of lower overhead and no bond issuance related expenses.

Recovery (Deferral) of Recoverable Costs

The individual components of the recovery (deferral) of recoverable costs are as follows for the three months ended September 30, 2012 and 2011 (in millions):

	2012	2011
Operations	$ (199)	$ (257)
Debt service and related costs	178	155
	$ (21)	$ (102)

Operations

There was a deferral of recoverable costs of $199 million for the three months ended September 30, 2012, compared to the $257 million deferral of recovery in the same period in 2011. The deferral in the three months ended September 30, 2012 reflects less power charge revenue received than needed to pay power costs as DWR purposefully reduces cash balances through lower rates to ratepayers.

Debt Service and Related Costs

The recovery of debt service and bond related costs are $23 million higher for the three months ended September 30, 2012 compared to the same period in 2011. The recovery is comprised solely of the difference between bond charges and interest income less interest expense. The larger recovery is due to higher revenues from the collection of bond charges.

LIQUIDITY

At September 30, 2012 and 2011, there are no outstanding amounts due under liquidity facilities.

Department of Water Resources Electric Power Fund
Statements of Net Assets
September 30, 2012 and June 30, 2012 (in millions)

	September 30, 2012	June 30, 2012
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 68	$ 267
Debt Service Reserve Account	919	919
Derivative instruments	-	-
Deferral of derivative cash outflows	-	1
Recoverable costs	5,056	5,038
Total long-term assets	6,043	6,225
Current assets:		
Restricted cash and equivalents:		
Operating and Priority Contract Accounts	383	398
Bond Charge Collection and Bond Charge Payment Accounts	823	582
Recoverable costs, current portion	111	131
Interest receivable	10	4
Derivative instruments, current portion	-	-
Deferral of derivative cash outflows, current portion	2	1
Other assets	43	45
Total current assets	1,372	1,161
Total assets	$ 7,415	$ 7,386
Capitalization and Liabilities		
Capitalization:		
Net assets	$ -	$ -
Long-term debt	6,663	6,667
Non-Current liabilities:		
Derivative instruments	-	1
Deferral of derivative cash inflows	-	-
Total capitalization and non-current liabilities	6,663	6,668
Current liabilities:		
Current portion of long-term debt	592	592
Derivative instruments, current portion	4	6
Deferral of derivative cash inflows, current portion	-	-
Accounts payable	14	63
Accrued interest payable	142	57
Total current liabilities	752	718
Commitments and Contingencies (Note 7)		
Total capitalization and liabilities	$ 7,415	$ 7,386

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

Department of Water Resources Electric Power Fund
Statements of Revenues, Expenses and Changes in Net Assets
For the three months ended September 30, 2012 and 2011 (in millions)

	2012	2011
Operating revenues:		
Power charges	$ (183)	$ 196
Surplus sales	$ -	11
Total operating revenues	(183)	207
Operating expenses:		
Power purchases	$ 12	469
Energy settlements	$ -	(10)
Administrative expenses	$ 4	6
Recovery (deferral) of recoverable operating costs	(199)	(257)
Total operating expenses	(183)	208
Income from operations	-	(1)
Bond charges	$ 252	230
Interest income	$ 7	6
Interest expense	$ (81)	(81)
Investment income from debt related derivatives	$ -	-
Investment income (expense) from gas related derivatives	$ -	1
Recovery of recoverable debt service and related costs	(178)	(155)
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 three months ended September 30, 2012 and 2011 (in millions)

	2012	2011
Cash flows from operating activities:		
Receipts:		
Power charges	$ (152)	$ 181
Surplus sales	2	20
Energy settlements	-	10
Payments for power purchases and other expenses	(63)	(480)
Net cash (used in) provided by operating activities	(213)	(269)
Cash flows from non-capital financing activities:		
Receipt of bond charges	242	230
Bond Payments	-	-
Interest payments	-	(3)
Proceeds from issuance of revenue bonds	-	1,116
Defeasance of revenue bonds	-	(1,119)
Net cash provided by non-capital financing activities	242	224
Cash flows from investing activities:		
Interest received on investments	1	3
Income received from derivative investments	(2)	3
Net cash provided by investing activities	(1)	6
Net increase (decrease) in cash and equivalents	28	(39)
Restricted cash and equivalents, beginning of period	1,865	2,658
Restricted cash and equivalents, end of period	$ 1,893	$ 2,619
Restricted cash and equivalents included in:		
Operating Reserve Account	$ 68	$ 288
Debt Service Reserve Account (a component of the total of $919 and $919 at September 30, 2012 and 2011, respectively)	619	619
Operating and Priority Contract Accounts	383	870
Bond Charge Collection and Bond Charge Payment Accounts	823	842
Restricted cash and equivalents, end of year	$ 1,893	$ 2,619
Reconciliation of operating income to net cash (used in) provided by operating activities:		
Income from operations	$ -	$ (1)
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
(Deferral) recovery of recoverable operating costs	(199)	(257)
	(199)	(258)
Changes in net assets and liabilities to reconcile operating income to net cash (used in) provided by operations:		
Recoverable costs	31	(6)
Other assets	4	11
Accounts payable	(49)	(16)
Net change in operating assets & liabilities:	(14)	(11)
Net cash (used in) provided by operating activities	$ (213)	$ (269)

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

1. Reporting Entity

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

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

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

DWR power is delivered to the customers through the transmission and distribution systems of the IOUs and payments from the customers are collected for DWR by the IOUs pursuant to servicing arrangements approved and/or ordered by the California Public Utilities Commission (the CPUC).

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

2. Summary of Significant Accounting Policies

Basis of Presentation

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

The financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the business-type activities and major funds of the State of California that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position of the State of California as of September 30, 2012 and 2011, and the changes in its financial position and its cash flows, where applicable, for the periods then ended in conformity with accounting principles generally accepted in the United States of America.

Revenues and Recoverable Costs

DWR is required to at least annually establish a revenue requirement determination to recover all Fund costs, including debt service. The revenue requirement determination is submitted to the California Public Utilities Commission which then sets customer remittance rates. The Fund's financial statements are prepared in accordance with 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 DWR are recorded as the current portion of recoverable costs.

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

3. Restricted Cash and Investments

As of September 30, 2012, the Fund had the following investments (in millions):

Investment	Maturity	September 30, 2012
State of California Pooled Money Investment Account - State Money Investment Fund	8.0 months avg.	$ 1,889
Cash		4
Total cash and equivalents		1,893
Guaranteed investment contracts	May 1, 2022	200
Forward purchase agreement	November 1, 2012	100
		$ 2,193
Reconciliation to Statement of Net Assets:		
Operating Reserve Account		$ 68
Debt Service Reserve Account		919
Operating and Priority Contract Accounts		383
Bond Charge Collection and Bond Charge Payment Accounts		823
		$ 2,193

Custodial Credit Risk: Custodial credit risk is the risk associated with a lack of diversification, such as having substantial unsecured deposits in a few individual financial institutions, thereby exposing the organization to greater risks resulting from adverse economic, political, regulatory, geographic or credit developments. The State of California has a deposit policy for custodial credit risk that requires deposits held by financial institutions to be insured by federal depository insurance or secured by collateral. As of September 30, 2012 none of the Fund's cash balances were uninsured and uncollateralized.

Interest Rate Risk: Interest rate risk is the risk that the value of fixed income securities will decline because of changing interest rates. The prices of fixed income securities with a longer time to maturity, measured by effective duration, tend to be more sensitive to changes in interest rates and, therefore, more volatile than those with shorter durations. The State Treasurers Investment Policy, Pooled Money Investment Account, provides for spreading investments over various maturities to minimize the risk of portfolio depreciation due to a rise in interest rates. The State Treasurers Investment Policy limits investments to the following maximum maturities: 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.

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 0.3% at September 30, 2012. For the three months ended September 30, 2012, interest earned on the deposit in the PMIA was $4 million.

Interest on the GICs is paid semi-annually at interest rates ranging from 5.3% to 5.5%. Interest earned on the GICs was $3 million for the three months ended September 30, 2012.

The FPA allows DWR to continuously reinvest funds in U.S. government or U.S. government agency securities through May 2022 to earn a minimum rate of return of 4.7%, as specified in the Reserve Fund Forward Purchase and Sale Agreement, dated May 1, 2004. The reinvested securities are to mature every six months. Interest earned on the FPA was $1 million for the three months ended September 30, 2012.

The Fund's investments in the guaranteed investment contracts and forward purchase agreement are rated as follows, by Standard & Poor's (S&P) and Moody's, respectively, at September 30, 2012 (in millions):

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

4. Long-Term Debt

The following activity occurred in the long-term debt accounts during the three months ended September 30, 2012 (in millions):

	Revenue Bonds	Unamortized Premium	Deferred Loss on Defeasance	Deferred Cost of Issuance	Total
Balance, June 30, 2012	$ 7,128	$ 506	$ (135)	$ (240)	$ 7,259
Amortization	-	(28)	8	16	$ (4)
Balance, September 30, 2012	7,128	478	(127)	(224)	$ 7,255
Less current portion	574	104	(29)	(57)	$ 592
	$ 6,554	$ 374	$ (98)	$ (167)	$ 6,663

The tax exempt revenue bonds consist of the following at September 30, 2012 (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding 2012	Current Portion
F	Fixed (4.38-5.00%)	2022	2018	$ 348	$ -
G	Fixed (4.35-5.00%)	2018	Non-callable	173	-
H	Fixed (3.75-5.0%)	2022	2018	1,007	-
K	Fixed (4.0-5.0%)	2018	Non-callable	279	-
L	Fixed (2.5-5.0%)	2022	2020	2,708	-
M	Fixed (2.0-5.0%)	2020	Non-callable	1,653	419
N	Fixed (2.0-5.0%)	2021	Non-callable	960	155
				$ 7,128	$ 574
Plus unamortized bond premium				478	104
Less deferred loss on defeasance				(127)	(29)
Less costs of issuance				(224)	(57)
				$ 7,255	$ 592

Bond refunding transactions

The Fund has issued revenue refunding bonds to advance refund various bonds that were previously issued. The net proceeds from these sales were used to purchase U.S. Treasury Securities that were deposited in irrevocable escrow trust accounts with the State Treasurer acting as an independent fiscal agent to provide for all future debt service on the bonds being refunded. As a result, those bonds are considered defeased and the related liabilities have been excluded from the Fund's basic financial statements. At September 30, 2012, there was no outstanding debt related to these defeased bonds.

On August 31, 2011, the Fund issued $960 million of revenue bonds at a true interest cost of 2.42% to refund $948 million of variable rate debt, consisting of $25 million of Series 2002 B bonds, and $923 million of Series 2002 C bonds. In addition, $159 million of the fixed rate debt Series 2002 A bonds were advance refunded to take advantage of lower interest rates. The Series 2011 N bonds were issued at a premium of $158 million with coupons ranging from 2.0% to 5.0%. The transaction resulted in a net cash flow savings of $7.8 million and an economic gain (difference between the present values of the debt service payments on the old debt and the new debt) of $4.9 million. The difference between the book value of the old debt and the amount required to retire the debt is deferred and amortized over the original remaining life of the old debt or the life of the new debt, whichever is less. The Fund incurred an accounting loss of $12 million, which included cost of issuance of $5 million. Bonds payable are reported net of these deferred costs. Such amounts will be amortized over the life of the Series 2011 N bonds since all defeased bonds had maturities that were similar to the maturities of the Series 2011 N bonds.

With the Series 2011 N refunding transaction, the Fund has no variable rate bonds outstanding. The Fund terminated all of the outstanding credit enhancement facilities relating to those 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 F, H, and L are callable at a redemption rate of 100 percent. The Series F and Series H are callable in 2018. The Series L bonds are callable in 2020. The Series G, K, M, and N are non-callable.

Maturities

Future payment requirements on the revenue bonds are as follows at September 30, 2012 (in millions):

Fiscal Year	Principal	Interest	Total
2013	$ 574	$ 340	$ 914
2014	611	314	925
2015	618	286	904
2016	669	258	927
2017	686	227	913
2018-22	3,970	607	4,577
	$ 7,128	$ 2,032	$ 9,160

5. Derivative Financial Instruments

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. DWR is party to 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 September 30 and June 30, 2012.

The fair values, classification and notional amounts outstanding for DWR's natural gas derivatives accounted for as derivative financial instruments at net assets as of September 30 and June 30, 2012 are summarized in the following tables:

As of September 30, 2012

		Business-type activities	Value	Notional	
Effective hedges					
Assets					
	Current	Gas Swaps	$ -	-	MMBtu
	Long Term	Gas Swaps	-	-	MMBtu
			$ -		
Liabilities					
	Current	Gas Swaps	$ (2)	535,000	MMBtu
	Long Term	Gas Swaps	-	152,500	MMBtu
			$ (2)		
Investment hedges					
Assets					
	Current	Gas Swaps	$ -	-	MMBtu
	Current	Gas Options	-	-	MMBtu
	Long Term	Gas Swaps	-	-	MMBtu
	Long Term	Gas Options	-	-	MMBtu
			$ -		
Liabilities					
	Current	Gas Swaps	$ (2)	530,000	MMBtu
	Current	Gas Options	-	-	MMBtu
	Long Term	Gas Swaps	-	-	MMBtu
			$ (2)		

Note: The Fund holds certain natural gas options in assets that have little value but still offer some price protection.

As of June 30, 2012

		Business-type activities	Value (in mllions)		Notional	
Effective hedges						
Assets						
	Current	Gas Swaps	$	-	-	MMBtu
	Long Term	Gas Swaps		-	-	MMBtu
			$	-		
Liabilities						
	Current	Gas Swaps	$	(1)	305,000	MMBtu
	Long Term	Gas Swaps		(1)	382,500	MMBtu
			$	(2)		
Investment hedges						
Assets						
	Current	Gas Swaps	$	-	-	MMBtu
	Current	Gas Options		-	200,000	MMBtu
	Long Term	Gas Swaps		-	-	MMBtu
	Long Term	Gas Options		-	-	MMBtu
			$	-		
Liabilities						
	Current	Gas Swaps	$	(5)	990,000	MMBtu
	Current	Gas Options		-	-	MMBtu
	Long Term	Gas Swaps		-	-	MMBtu
			$	(5)		

Note: The Fund holds certain natural gas options in assets that have little value but still offer some price protection.

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.

Commodity contracts

DWR entered into natural gas hedge contracts, futures and options, to hedge the cost of natural gas. At September 30, 2012, DWR no longer has any outstanding natural gas option contracts. In prior years, all natural gas options are treated as derivatives and are classified as investment derivatives since they do not meet GASB 53 hedging criteria.

For DWR's natural gas futures contracts that are effective hedges, unrealized gains and losses are deferred on the statement of net assets as current assets or liabilities for contracts with less than 12 months remaining until expiration, or as long-term assets or liabilities for contracts with more than 12 months remaining until expiration. The deferred amount recorded on the statements of net assets reflects the deferred inflow or outflow associated with the derivative financial instruments.

In fiscal 2013, DWR no longer has any forward natural gas purchase contracts. In prior years, most of DWR's forward natural gas purchases are 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.

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: DWR's open natural gas futures positions at September 30, 2012 have been entered into through DWR's brokerage accounts and the associated clearing accounts have collateral requirements that limit DWR's counterparty credit risk.

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

6. Commitments and Contingencies

Litigation and Regulatory Proceedings

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

California Refund Proceedings: During 2001 and 2002, DWR purchased power in bilateral transactions (both short term and long term), sold power to the CAISO, paid for power purchased by the CAISO and purchased power from the CAISO for sale to customers of the IOUs. In July 2001, the Federal Energy Regulatory Commission (FERC) initiated an administrative proceeding to calculate refunds for inflated prices in the CAISO and California Power Exchange (CalPX) markets during 2000 and 2001. FERC ruled that DWR would not be entitled in that proceeding to approximately $3,500 million in refunds associated with DWR's approximately $5,000 million of short term purchases because DWR made those purchases bilaterally, not in the CalPX or CAISO markets. The Ninth Circuit Court of Appeals affirmed FERC, but left open the possibility of refunds on DWR's bilateral purchases in other FERC proceedings. In contrast, FERC ruled that DWR is entitled to refunds on purchases made by the CAISO where DWR actually paid the bill.

Of DWR's $5,000 million in short term bilateral purchases, $2,900 million was imbalance energy which DWR sold to the CAISO at DWR's cost in order to meet the CAISO's emergency needs during 2001. DWR is treated in the FERC refund proceeding as a seller of that energy to CAISO, and in May 2004, FERC issued an order requiring DWR to pay refunds on the sales to the CAISO. However, because DWR would likely be the primary recipient of any refunds on energy it sold to the CAISO, DWR's potential net liability associated with its sales to the CAISO would be substantially reduced. Settlements executed to date with various sellers have reduced that potential liability even further.

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

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

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

Accordingly, although subject to uncertainty, DWR expects it likely will be a net refund recipient in the FERC proceedings. Due to pending litigation that could significantly increase or decrease the level of the refunds DWR would be entitled to receive, DWR has not recorded any amounts related to this issue. However, DWR does not expect that FERC will order it to pay more in refunds than it receives on a market-wide basis.

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

During fiscal year 2011, three of DWR's power purchase contracts were novated. Management does not believe it is likely that there will be additional contract novations because only three power purchase contracts remain after June 30, 2012.

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 DWR's revenue requirement will be recovered in the same manner as has been successfully implemented over the duration of the Power Supply Program.

Other Contingencies

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

Commitments

DWR has power purchase contracts that have remaining lives of up to four years. Payments under these and gas purchase contracts approximated $12 million and $469 million for the three month periods ended September 30, 2012 and 2011, respectively.

In addition to the remaining purchased power contracts, the remaining fixed obligations include a natural gas transmission capacity contract that expires in fiscal 2018. There are no associated natural gas purchase requirements with this contract.

The remaining amounts of fixed obligations under the contracts as of September 30, 2012, are as follows (in millions):

For the Year Ending June 30,	Fixed Obligation (in millions)
2013	$ 31
2014	34
2015	25
2016	16
2017	15
2018	12
	$ 133

In addition to the fixed costs there are variable costs under several of the contracts. Management projects as of September 30, 2012 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $147 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 used as fuel.

All of the power contracts qualify under the normal purchases and normal sales exclusion under the provisions of GASB 53 since it is probable that DWR will take delivery of the commodity and DWR uses the commodity in its operations as in the normal course of business.

7. Energy Settlements

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

In quarter ended September 30, 2012, there were no revenues received from energy settlements.

In the quarter ended September 30, 2011, the Fund received $10 million in energy settlements. The Fund received $6 million as part of the FERC refund settlement agreement signed by the California Parties (CPUC, the State Attorney General, California Department of Water Resources acting through the Fund, Southern California Edison, San Diego Gas and Electric Company, and Pacific Gas and Electric Company) and the City of Pasadena. The Fund also received $3 million from the Modesto Irrigation District ("MID") as part of the FERC refund settlement agreement signed by the California Parties and MID. Lesser amounts were received from FERC refund settlement agreements with the cities of Santa Clara, Seattle, Glendale, and Burbank, PPL Montana and the Turlock Irrigation District.

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