NEW ISSUE – BOOK-ENTRY ONLY

RATINGS (see "RATINGS" herein):
Fitch Ratings: A+
Moody's: Aa3
Standard & Poor's: A

In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the Department of Water Resources of the State of California with respect to this financing, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Series 2008K Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) interest on the Series 2008K Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In addition, in the opinion of Bond Counsel, under existing statutes, interest on the Series 2008K Bonds is exempt from State of California personal income taxes. See "TAX MATTERS" herein.

$279,250,000

State of California Department of Water Resources

Power Supply Revenue Bonds, Series 2008K

Dated: Date of Delivery **Due: May 1, 2018**

Interest on the Series 2008K Bonds is payable on May 1 and November 1 of each year, commencing November 1, 2008. Series 2008K Bonds may be purchased in book-entry form only, in principal amounts of $5,000 or any integral multiple thereof. See APPENDIX B - "BOOK-ENTRY SYSTEM."

The Department of Water Resources ("DWR") of the State of California (the "State") has issued several series of its Power Supply Revenue Bonds (the "Bonds") under a Trust Indenture, as amended and supplemented (the "Indenture") among DWR, the Treasurer of the State of California, as trustee (the "Trustee") and U.S. Bank National Association, as co-trustee (the "Co-Trustee"). The Series 2008K Bonds are being issued to refund certain outstanding variable rate Bonds issued in 2005. See "PLAN OF REFUNDING."

The Bonds are payable primarily from charges ("Bond Charges") to be imposed by the California Public Utilities Commission ("CPUC") upon customers in the service areas of the three major investor-owned electric utilities in California. The CPUC has covenanted in a rate agreement with DWR (the "Rate Agreement") to calculate, revise and impose Bond Charges sufficient to pay debt service on the Bonds and other Bond Related Costs when due, as explained under "SECURITY FOR THE BONDS – Bond Related Costs" and "– Rate Covenants," and under "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – Rate Agreement." In the Indenture, DWR has pledged and assigned its revenues from Bond Charges for the payment of debt service on the Bonds and Parity Obligations when due, subject to the possible prior use of revenues from Bond Charges to pay amounts due under Priority Long-Term Power Contracts (as defined in the Indenture), as explained under "SECURITY FOR THE BONDS."

This cover page contains certain information for general reference only. It is not a summary. Investors must read the entire Official Statement to obtain information essential to making an informed investment decision. **See "RISK FACTORS" for certain risks that should be considered by investors in deciding whether to purchase Series 2008K Bonds.**

THE BONDS SHALL NOT BE OR BE DEEMED TO CONSTITUTE A DEBT OR LIABILITY OF THE STATE OR OF ANY POLITICAL SUBDIVISION THEREOF OR A PLEDGE OF THE FAITH AND CREDIT OF THE STATE OR OF ANY SUCH POLITICAL SUBDIVISION, OTHER THAN DWR TO THE EXTENT PROVIDED IN THE INDENTURE. THE BONDS SHALL BE PAYABLE SOLELY FROM THE FUNDS PLEDGED THEREFOR PURSUANT TO THE INDENTURE. THE BONDS SHALL NOT DIRECTLY OR INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OR ANY POLITICAL SUBDIVISION THEREOF TO LEVY OR TO PLEDGE ANY FORM OF TAXATION WHATEVER THEREFOR OR TO MAKE ANY APPROPRIATION FOR THEIR PAYMENT.

Certain legal matters incident to the authorization, sale and issuance of the Series 2008K Bonds are subject to the approval of The Honorable Edmund G. Brown Jr., Attorney General of the State of California, and of Hawkins Delafield & Wood LLP, Bond Counsel to DWR. Certain legal matters will be passed upon for DWR by David Sandino, Chief Counsel to DWR, and Orrick, Herrington & Sutcliffe LLP, Disclosure and Special Counsel to DWR. Certain legal matters will be passed upon for the CPUC by Lionel B. Wilson, Interim General Counsel to the CPUC, and Paul, Weiss, Rifkind, Wharton & Garrison LLP, Special Counsel to the CPUC. Certain legal matters will be passed upon for the Underwriters by Nixon Peabody LLP, counsel to the Underwriters. It is expected that the Series 2008K Bonds will be available for delivery on or about May 8, 2008.

Honorable Bill Lockyer
Treasurer of the State of California

JPMorgan

Bear, Stearns & Co. Inc.

Banc of America Securities LLC **Blaylock Robert Van, LLC**
Citi **Estrada Hinojosa & Company, Inc.**
Morgan Stanley & Co. Incorporated **NAFA Capital Markets, LLC**
Stone & Youngberg

Merrill Lynch & Co.

Butler Wick & Co., Inc. **Cabrera Capital Markets, LLC**
Goldman, Sachs & Co. **Loop Capital Markets, LLC**
RBC Capital Markets **Roberts & Ryan Investments Inc.**
Sutter Securities Incorporated

April 29, 2008

MATURITY SCHEDULE

$279,250,000 Series 2008K Bonds

Maturity Date (May 1)	Principal Amount	Interest Rate	Yield	CUSIP* Number
2018	$ 25,975,000	4.00%	4.10%	13066YNK1
2018	253,275,000	5.00%	4.10%	13066YNL9

* Copyright 2008. CUSIP is a registered trademark of the American Bankers Association. CUSIP data herein is provided by Standard & Poor's CUSIP Service Bureau, a division of The McGraw–Hill Companies, Inc. CUSIP numbers are provided for convenience of reference only. Neither DWR nor the Underwriters assumes any responsibility for the accuracy of such numbers.

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Copies of this Official Statement may be obtained from:

HONORABLE BILL LOCKYER
Treasurer of the State of California
P.O. Box 942809
Sacramento, California 94209-0001
1-800-900-3873

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GENERAL INFORMATION

For an index of defined terms used in this Official Statement, see APPENDIX G – "INDEX OF PRINCIPAL DEFINITIONS." Capitalized terms used, but not defined in this Official Statement have the meanings given in the Indenture. For definitions of certain terms used in the Indenture, see APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE."

Descriptions and summaries of CPUC orders, the Rate Agreement, the Indenture, the Series 2008K Bonds, DWR's servicing arrangements, DWR's power supply contracts (including the Priority Long-Term Power Contracts), Division 27 (commencing with Section 80000) of the California Water Code, as amended from time to time (the "Act"), and other documents, regulations and laws referred to in this Official Statement do not purport to be complete and reference is made to each of them for a complete statement of their provisions. A copy of the Rate Agreement is attached as Appendix D to this Official Statement. Copies of DWR's power supply contracts are posted on DWR's Internet site at www.cers.water.ca.gov. Copies of other DWR documents may be obtained by request to DWR at cersforum@water.ca.gov or 3310 El Camino Avenue, Suite 120, Sacramento, California 95821, Attention: Chief, Financial Management Office, Power Supply Program, upon payment of a reproduction fee.

So far as any statements made in this Official Statement involve matters of opinion, assumptions, projections, anticipated events or estimates, whether or not expressly stated, they are set forth as such and not as representations of fact, and actual results may differ substantially from those set forth herein. Neither this Official Statement nor any statement which may have been made verbally or in writing is to be construed as a contract with the owners of the Series 2008K Bonds.

No person has been authorized to give information or to make any representations other than those contained in this Official Statement; and, if given or made, such other information or representations must not be relied upon as having been authorized by DWR or the State. This Official Statement does not constitute an offer to sell or a solicitation of an offer to buy, nor shall there be any sale of the Series 2008K Bonds offered hereby by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale. This Official Statement speaks only as of its date and any information, estimates and/or expressions of opinion herein are subject to change without notice; and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no material change in the affairs of DWR or the CPUC since the date hereof.

The information set forth herein has been obtained from sources that are believed to be reliable, but it is not guaranteed as to accuracy or completeness. The presentation of information is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of DWR or the CPUC. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future.

This Official Statement includes forward looking statements that are based on DWR's current expectations and projections about future events. These forward looking statements are subject to risks and uncertainties, including risks and uncertainties outside the control of DWR. Such statements generally are identifiable by the terminology used, such as "plan," "expect," "estimate," "budget," "believes," "projects" or other similar words. Such forward-looking statements include but are not limited to certain statements contained under the captions "SUMMARY," "PLAN OF REFUNDING," "SECURITY FOR THE BONDS," "THE DWR POWER SUPPLY PROGRAM," "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES," "LITIGATION AND ADMINISTRATIVE PROCEEDINGS," "RISK FACTORS," and "TAX MATTERS" in this Official Statement. The achievement of certain results or other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. DWR does not plan to issue any updates or revisions to these forward-looking statements if or when expectations or events, conditions or circumstances on which such statements are based occur or fail to occur.

A wide variety of other information, including financial information, concerning DWR and the State is available from DWR, the State Treasurer, the State and publications and websites of DWR, the State Treasurer, the State and various State agencies and officials, including the CPUC. Except as expressly provided otherwise herein, no such information is a part of or incorporated into this Official Statement.

The CPUC makes no representation as to the accuracy or completeness of this Official Statement, including any forward looking statements or projections contained in this Official Statement and any description in this Official Statement of litigation involving or affecting the CPUC. Any statements regarding such litigation do not necessarily represent the CPUC's view of such litigation or any position in such litigation. In addition, while CPUC staff may have assisted in the preparation of certain sections of this Official Statement, the CPUC can only take positions through formal action and has not taken any such action or approved this Official Statement. The CPUC is an independent five member body that must act by an affirmative vote of a majority of its members and, as a result, the CPUC can only indicate its views in formal decisions or other formal actions. In addition, the CPUC is an independent body not subject to the control of DWR and may take positions in the future different from DWR in litigation or other matters described in this Official Statement. As a result, statements in this Official Statement regarding electricity markets and regulation, and DWR's views of the CPUC's role or DWR's role in such markets and regulation, do not necessarily represent the views, opinions or beliefs of the CPUC and should not be construed as such by any recipient of this Official Statement.

Information in this Official Statement about the major investor-owned utilities in California, Pacific Gas & Electric Company, San Diego Gas & Electric Company and Southern California Edison (collectively, the "IOUs") has been obtained from publicly available documents. Each of the IOUs and the parent companies of each of the IOUs named under "THE DWR POWER SUPPLY PROGRAM – Customer Base" file annual, quarterly and certain other reports with the Securities and Exchange Commission ("SEC"). Such reports are available on the SEC's website (www.sec.gov) and upon request from the Office of Public Reference of the SEC, 450 5th Street, NW, Room 1300, Washington, D.C. 20549-0102 (phone: (202) 942-8090; fax: (202) 628-9001; e-mail: publicinfo@sec.gov). No such report is a part of or incorporated into this Official Statement. Filings by each of the IOUs with the Federal Energy Regulatory Commission ("FERC") may be found on FERC's website (www.ferc.gov). No such report on the SEC's website or report on the FERC website is a part of or incorporated into this Official Statement. The information referred to in this paragraph has not been independently verified and DWR and the Underwriters do not warrant that this information is accurate or complete.

In connection with this offering the Underwriters may over-allot or effect transactions that stabilize or maintain the market prices of the Series 2008K Bonds offered hereby at levels above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time.

The Underwriters have provided the following sentence for inclusion in this Official Statement: The Underwriters have reviewed the information in this Official Statement in accordance with, and as a part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

OFFICIAL STATEMENT

$279,250,000
State of California Department of Water Resources
Power Supply Revenue Bonds, Series 2008K

SUMMARY

This summary is a brief description of the Series 2008K Bonds and this Official Statement. A full review should be made of the entire Official Statement, including the Appendices. The Index of Principal Definitions in Appendix G lists the pages on which the definitions of principal terms used in this Official Statement appear.

General ..... This Official Statement describes the State of California (the "State") Department of Water Resources ("DWR") Power Supply Program, DWR's Power Supply Revenue Bonds (the "Bonds"), including the Power Supply Revenue Bonds, Series 2008K (the "Series 2008K Bonds") offered hereby in the principal amount of $279,250,000. See "SECURITY FOR THE BONDS" and "DESCRIPTION OF THE SERIES 2008K BONDS."

Outstanding Bonds; Plan of Refunding ..... In 2002, DWR issued Bonds in the aggregate principal amount of $11,263,500,000 (the "Series 2002 Bonds") for the purpose of financing and refinancing costs of the Power Supply Program. In 2005, DWR issued Bonds in the aggregate principal amount of $2,594,000,000 (the "Series 2005 Bonds") to refund certain of the Series 2002 Bonds. On March 20, 2008, DWR issued the fixed rate Series 2008H Bonds (the "Series 2008H Bonds") to refund certain additional Series 2002 Bonds and Series 2005 Bonds bearing interest at variable rates. On April 2, 2008, DWR issued the variable rate Series 2008I Bonds (the "Series 2008I Bonds") to refund certain other Series 2002 Bonds. On April 17, 2008, DWR issued the variable rate Series 2008J Bonds (the "Series 2008J Bonds") to refund certain other Series 2005 Bonds. DWR is issuing the Series 2008K Bonds to refund an additional $295,000,000 principal amount of Series 2005 Bonds that are variable rate demand bonds and to pay certain costs of issuance of the Series 2008K Bonds. The Series 2008H Bonds, the Series 2008I Bonds, the Series 2008J Bonds and the Series 2008K Bonds are herein collectively referred to as the "Series 2008 Bonds." DWR's 2008 plan of refunding is intended to reduce DWR's exposure to certain markets for bonds bearing interest at variable rates due to the volatility, uncertainty and disruption in such markets. Upon the issuance of the Series 2008 Bonds, approximately $9.5 billion aggregate principal amount of Bonds will remain "Outstanding" (as defined in Appendix C). See "PLAN OF REFUNDING."

The Series 2002 Bonds, Series 2005 Bonds, Series 2008 Bonds and any additional Bonds that are Outstanding from time to time under the Indenture will be secured by and payable from the Trust Estate on a parity basis. See "SECURITY FOR THE BONDS."

Bond Authorization ..... The Series 2008K Bonds are being issued under Division 27 (commencing with Section 80000) of the California Water Code, as amended from time to time (the "Act") and a Trust Indenture, as amended and supplemented (the "Indenture"), including, with respect to the Series 2008K Bonds, as supplemented by an Eighth Supplemental Trust Indenture (the "Eighth Supplemental Indenture") among DWR, the Treasurer of the State, as Trustee, and U.S. Bank National Association, as Co-Trustee (collectively, the "Trustees").

The Series 2008K Bonds..... The Series 2008K Bonds will be dated the date of their delivery, will mature on the date and in the amounts, and will bear interest at the rates shown on the inside cover of this Official Statement. Interest on the Series 2008K Bonds is payable on May 1 and November 1 of each year, commencing November 1, 2008. Series 2008K Bonds may be purchased in book-entry form only, in principal amounts of $5,000 or any integral multiple thereof.

Department of Water Resources ..... DWR was established in 1956 under California law as a department of the State. The Director and Chief Deputy Director of DWR are appointed by the Governor and, as a part of the Executive Branch, report to the Governor through the Secretary of the Resources Agency. DWR has been operating the Power Supply Program since early 2001. See "THE DWR POWER SUPPLY PROGRAM." Under the Power Supply Program, DWR has been purchasing power for sale to end use customers in the service areas of the three major investor-owned electric utilities in the State, Pacific Gas and Electric Company ("PG&E"), Southern California Edison ("SCE"), and San Diego Gas & Electric Company ("SDG&E") (collectively, the "IOUs").

Power Supply Program ..... DWR established the Power Supply Program in 2001, when Governor Gray Davis determined that the IOUs could not supply electric power sufficient to prevent widespread and prolonged disruption of electric service in California. Governor Davis proclaimed a state of emergency, and directed DWR to procure electric power for retail customers of the IOUs. During 2001 and 2002, DWR entered into both short-term and long-term contracts to purchase power from wholesale suppliers, and supplied the portion of the retail load that the IOUs could not provide (the "net short"). DWR continues to purchase wholesale power to satisfy the net short, but only through long-term wholesale power contracts that DWR entered into prior to December 31, 2002. On that date, DWR's statutory authority to enter into new power purchase arrangements expired, and DWR has not made any spot market purchases and has not entered into any new power contracts since that date. As DWR's existing power contracts expire, the IOUs are required to replace that power as needed. See "THE DWR POWER SUPPLY PROGRAM."

DWR recovers the costs of the Power Supply Program through "Bond Charges" and "Power Charges," which are imposed by the CPUC on the approximately 11 million bundled customers and certain direct access, departing load and Community Choice Aggregation customers. A "bundled customer" is a retail customer that purchases electrical energy and transmission and distribution services from an IOU. A "direct access" customer is a retail customer who purchases electrical energy from an electric service provider but purchases transmission and distribution services from an IOU. An "electric service provider" is a privately-owned retail seller of electrical energy, other than an IOU that is regulated by the CPUC, as defined with more particularity in Appendix D. A "departing load" customer is a retail customer who commences customer generation (sometimes called "self-generation") or whose load was or was projected to be served by the IOU, but who is now receiving electrical energy and transmission and distribution services from a publicly owned utility. A "Community Choice Aggregation" customer is a retail customer that receives electrical energy from a

Community Choice Aggregator pursuant to California Public Utilities Code Section 366.2.

Bond Charges are the primary source of money to pay debt service on the Bonds, and must be imposed by the CPUC whether or not DWR continues to purchase or sell electricity under the Power Supply Program. Power Charges are the primary source of money to procure wholesale power and pay other operating costs of the Power Supply Program. See "SECURITY FOR THE BONDS – Rate Covenants" and "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – Rate Agreement."

California Public Utilities Commission..... Under California law and the Rate Agreement (described below), the CPUC sets Bond Charges and Power Charges to recover DWR's statutorily defined revenue requirements and allocates such charges among service areas and electric customers. The CPUC has also adopted a number of decisions that implement other aspects of the Power Supply Program. See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES."

The CPUC was established in 1911 under the California Constitution and the California Public Utilities Act enacted in 1912. The CPUC is an independent regulatory agency and is not controlled by DWR. The CPUC regulates the IOUs and other California entities, mostly investor-owned electric, telecommunications, natural gas, water, railroad and passenger transportation companies. See "CALIFORNIA PUBLIC UTILITIES COMMISSION."

The CPUC makes no representation as to the accuracy or completeness of this Official Statement, including any forward-looking statements or projections contained in this Official Statement and any description in this Official Statement of litigation involving or affecting the CPUC. Any statements regarding such litigation do not necessarily represent the CPUC's view of such litigation or any position in such litigation. In addition, while CPUC staff may have assisted in the preparation of certain sections of this Official Statement, the CPUC can only take positions through formal action and has not taken any such action or approved this Official Statement. The CPUC is an independent five member body that must act by an affirmative vote of a majority of its members and, as a result, the CPUC can only indicate its views in formal decisions or other formal actions. In addition, the CPUC is an independent body not subject to the control of DWR and may take positions in the future different from DWR in litigation, or other matters described in this Official Statement. As a result, statements in this Official Statement regarding electricity markets and regulation, and DWR's views of the CPUC's role or DWR's role in such markets and regulation, do not necessarily represent the views, opinions or beliefs of the CPUC and should not be construed as such by any recipient of this Official Statement.

Rate Covenants and Bond Charges..... The Bonds are payable primarily from charges ("Bond Charges") to be imposed by the CPUC upon the approximately 11 million bundled customers and certain direct access, departing load and Community Choice Aggregation customers in the service areas of the IOUs. In the Rate Agreement with DWR (the "Rate Agreement"), the CPUC has covenanted to calculate, revise and impose from time to time, Bond Charges sufficient to provide moneys so that amounts available for deposit in the Bond Charge

Payment Account under the Indenture from time to time, together with amounts on deposit in the Bond Charge Payment Account, are at all times sufficient to pay or provide for the payment of debt service on the Bonds and other Bond Related Costs (as defined in the Rate Agreement) when due in accordance with the Indenture and other financing documents. See "SECURITY FOR THE BONDS – Rate Covenants" and "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – Rate Agreement."

Under the Act and the Rate Agreement, DWR is responsible for notifying the CPUC of the amounts required to pay Bond Related Costs that are to be recovered from Bond Charges. See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – Rate Agreement." Under the Rate Agreement, DWR is also responsible for notifying the CPUC of DWR's "Retail Revenue Requirements" (defined in the Rate Agreement as the amounts required to pay DWR costs that are to be recovered from Power Charges imposed by the CPUC from time to time). Retail Revenue Requirements do not include Bond Related Costs recovered from Bond Charges.

In the Indenture, DWR has covenanted to cause to be established, fixed and revised from time to time, charges sufficient, together with any other available moneys and securities on deposit in DWR's Electric Power Fund, to satisfy all of DWR's revenue requirements at the times and in the amounts needed. The term "revenue requirement" means the amounts needed from time to time by DWR to satisfy its obligations under the Act and under proclamations and orders issued pursuant to the California Emergency Services Act that are identified in the Indenture. These obligations include, but are not limited to, making deposits to the Bond Charge Payment Account and Debt Service Reserve Account in the amounts and at the times required by the Indenture. See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – DWR Actions to Establish Revenue Requirements."

Bond Related Costs..... Bond Related Costs that are payable from Bond Charges imposed by the CPUC under the Rate Agreement include, among other costs, debt service on the Bonds and payments required to be made: (i) under agreements with issuers of credit and liquidity facilities, including letters of credit, bond insurance, guarantees, debt service reserve fund surety bonds, lines of credit, reimbursement agreements, and standby bond purchase agreements, (ii) under agreements relating to other financial instruments entered into in connection with the Bonds, including but not limited to investment agreements, hedges, interest rate swaps, caps, options and forward purchase agreements, and (iii) under agreements relating to the remarketing of Bonds, including but not limited to remarketing agreements, dealer agreements and auction agent agreements. Such payments may cover fees, expenses, indemnification, or other obligations due the providers of any such facilities or parties to such agreements, and such agreements may be entered into at any time concurrently with or after the issuance of Bonds. See "SECURITY FOR THE BONDS – Bond Related Costs."

In connection with the issuance of variable interest rate Bonds, DWR has entered into and expects to enter into agreements, such as agreements with issuers of credit and liquidity facilities and agreements with interest rate swap providers, requiring the payment

of certain Bond Related Costs on a parity with payment of debt service on the Bonds. See "SECURITY FOR THE BONDS – Bond Related Costs."

Security for the Bonds; Bond Charge Revenues ..... The primary source of moneys for the payment of debt service on the Bonds and other Bond Related Costs will be Bond Charge Revenues, which constitute part of the Trust Estate securing the Bonds, as described below.

The "Trust Estate" is assigned and pledged to the Trustees under the Indenture for the benefit of the Bonds and Parity Obligations, subject to the use of the Trust Estate in accordance with the Indenture. The "Trust Estate" is defined in the Indenture to include, among other things, "Revenues." The term "Revenues" includes "Bond Charge Revenues," "Power Charge Revenues" and "Direct Access Power Charge Revenues." The term "Revenues" also includes (1) revenues from a surcharge (referred to herein as the "Cost Responsibility Surcharge") on direct access customers, various types of "departing load" and from other possible future sources as described under "THE DWR POWER SUPPLY PROGRAM – Direct Access, Departing Load and Community Choice Aggregation" and "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES," and (2) moneys actually received by the Department which have been recovered as compensation or damages from providers of power purchased by the Department under the Power Supply Program.

- "Bond Charge Revenues" are Revenues received by DWR arising from Bond Charges imposed by the CPUC upon customers in the service areas of the IOUs as described under "SECURITY FOR THE BONDS – Rate Covenants" and "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES."

- "Power Charge Revenues" are Revenues received by DWR arising from Power Charges imposed by the CPUC upon customers for electric power deemed sold to customers by DWR as described under "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES."

- "Direct Access Power Charge Revenues" are Revenues received by DWR from Direct Access Power Charges imposed by the CPUC upon any person receiving power from an "Electric Service Provider" (as that term is defined in the Rate Agreement, attached as Appendix D).

The use of amounts on deposit in the Bond Charge Collection Account (including Bond Charge Revenues) for the payment of debt service on the Bonds and other Bond Related Costs when due is subject to the possible prior use of such amounts to pay amounts due under Priority Long-Term Power Contracts ("Priority Contract Costs"). To date, no amounts on deposit in the Bond Charge Collection Account have been needed or used to pay Priority Contract Costs. See "SECURITY FOR THE BONDS" and "RISK FACTORS – Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs."

Sources of Payment of Operating Expenses; Priority Long-Term Power Contracts .....

Power Supply Program operating expenses, including Priority Contract Costs, are expected to be paid from Power Charge Revenues, Direct Access Power Charge Revenues and other Revenues (other than Bond Charge Revenues). Each Priority Long-Term Power Contract (see "SECURITY FOR THE BONDS – Priority Long-Term Power Contracts") contains a provision requiring that payments by DWR under the contract are to be paid or payable prior to payment of Bond Related Costs. Substantially all of the power to be purchased by DWR will be purchased under Priority Long-Term Power Contracts and for that reason substantially all of the operating expenses of the Power Supply Program will be Priority Contract Costs. The CPUC has covenanted to calculate, revise and impose Power Charges sufficient to satisfy the Retail Revenue Requirements, including Priority Contract Costs, as specified by DWR. See "SECURITY FOR THE BONDS – Rate Covenants." See also "RISK FACTORS – Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs."

Accounts and Flow of Funds under the Indenture.....

The Indenture establishes within the Electric Power Fund two sets of accounts for Revenues. One set of accounts, the "Bond Charge Accounts," is primarily for the deposit of Bond Charge Revenues and the payment of Bond Related Costs. Another set of accounts, the "Power Charge Accounts," is primarily for the deposit of Power Charge Revenues and the payment of operating expenses (including Priority Contract Costs and other costs of the Power Supply Program). Bond Charge Accounts include the Bond Charge Collection Account, the Bond Charge Payment Account, and the Debt Service Reserve Account. Power Charge Accounts include the Operating Account, the Priority Contract Account and the Operating Reserve Account. See "SECURITY FOR THE BONDS – Accounts and Flow of Funds under the Indenture."

Bond Charge Accounts.....

The Indenture requires the following deposits and transfers of Bond Charge Revenues:

- All Bond Charge Revenues are required to be deposited in the Bond Charge Collection Account. DWR is also required to deposit in the Bond Charge Collection Account any payments received from any counterparty to a "Qualified Swap" (as defined in Appendix C) relating to Bonds.

- On or before the last Business Day of each month, DWR is required to transfer from the Bond Charge Collection Account to the Bond Charge Payment Account such amount as is necessary to make the amount in the Bond Charge Payment Account sufficient to pay Bond Related Costs (including Debt Service on the Bonds) estimated to accrue or be payable during the next succeeding three calendar months. Each such transfer is subject to the prior transfer of amounts in the Bond Charge Collection Account to the Priority Contract Account if and to the extent amounts in the Priority Contract Account, the Operating Account and the Operating Reserve Account are insufficient to pay Priority Contract Costs. To date, no such transfer of amounts on deposit in the Bond Charge Payment Account has occurred. See "RISK FACTORS – Determination

of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs."

- Deficiencies in the Bond Charge Payment Account are required to be made up first, from the Operating Account and second, from the Debt Service Reserve Account (except for the payment of Fiduciary costs).
- The Debt Service Reserve Account is required by the Indenture to have a balance in the amount of the maximum aggregate annual Debt Service on all outstanding Bonds, calculated in accordance with the Indenture (the "Debt Service Reserve Requirement"). Each month after the Bond Charge Payment Account is funded as described above, Revenues are to be transferred to the Debt Service Reserve Account and to any reserve established for Parity Obligations to the extent necessary to meet the respective requirements (including replenishment requirements) for such reserves. Amounts in the Debt Service Reserve Account may be used for the payment of Bond Related Costs (including debt service on the Bonds) except Fiduciary costs, but only if amounts in the Bond Charge Payment Account and Operating Account are insufficient for that purpose. See "SECURITY FOR THE BONDS – Accounts and Flow of Funds under the Indenture" and "– Debt Service Reserve Account."

Power Charge Accounts..... The Indenture requires the following deposits and transfers of all Revenues other than those required to be deposited in the Bond Charge Collection Account:

- All Revenues (including but not limited to Power Charge Revenues), other than Bond Charge Revenues and payments to DWR under Qualified Swaps relating to Bonds, are required to be deposited in the Operating Account.
- On or before the fifth Business Day of each month, DWR is required to transfer from the Operating Account to the Priority Contract Account such amount as is necessary to make the amount in the Priority Contract Account sufficient to pay Priority Contract Costs estimated to be due during the balance of such month and through the first five Business Days of the next succeeding calendar month. Amounts in the Priority Contract Account may be used solely to pay Priority Contract Costs. See "SECURITY FOR THE BONDS – Accounts and Flow of Funds under the Indenture."
- Amounts in the Operating Account after the monthly transfer to the Priority Contract Account are to be used for the following purposes in the following order of priority: (i) for transfer to the Priority Contract Account if the estimated amount transferred to that account (as described in the preceding paragraph) is insufficient to pay actual Priority Contract Costs then payable; (ii) for the payment of other operating expenses; (iii) to reimburse the Bond Charge Collection Account for amounts previously transferred from the Bond Charge Collection Account to the Priority Contract Account to pay Priority Contract Costs; (iv) to pay debt service on the Bonds and other Bond Related Costs (if amounts in the Bond Charge

Payment Account are not sufficient for those purposes) and, in addition, prior to the time Bond Charge Revenues are received in amounts sufficient to make the transfers described in the second bullet point under "Bond Charge Accounts" above, to make those transfers as required; (v) for transfer to the Debt Service Reserve Account to the extent required by the Indenture as a result of the use of Bond Charge Revenues to pay Priority Contract Costs or a change in value of investments in such Account; (vi) to replenish the Operating Reserve Account to its requirement as provided by the Indenture; (vii) to pay any subordinated indebtedness and subordinated obligations and certain other amounts relating thereto; and (viii) for any other lawful purpose of the Power Supply Program. See "SECURITY FOR THE BONDS – Accounts and Flow of Funds under the Indenture," "– Debt Service Reserve Account" and " – Operating Reserve Account."

- The Operating Reserve Account is required by the Indenture to be funded in an amount equal to the Operating Reserve Account Requirement. Amounts in the Operating Reserve Account are to be transferred to the Operating Account if and to the extent that the amount in the Operating Account is insufficient for any of the purposes listed in clauses (i) through (v) of the preceding paragraph, unless the amount in the Operating Reserve Account is equal to or less than the "Priority Contract Contingency Reserve Amount" (an amount equal to the maximum amount projected by DWR to be payable under Priority Long-Term Power Contracts in any calendar month during the then-current revenue requirement period), in which event amounts in the Operating Reserve Account may only be used to make up any deficiency in the Priority Contract Account. See "SECURITY FOR THE BONDS – Accounts and Flow of Funds under the Indenture" and " – Operating Reserve Account."

Collection of Revenues; Servicing Arrangements..... Pursuant to the Act, the CPUC has issued orders approving servicing agreements or orders for the IOUs to provide transmission and distribution services, bill and collect Bond Charges and Power Charges, and perform other services on behalf of DWR in connection with the Power Supply Program (collectively, the "Servicing Arrangements"). Under such Servicing Arrangements, the IOUs collect DWR's Bond Charges and Power Charges solely as the agents of DWR. See "THE DWR POWER SUPPLY PROGRAM – Collection of Revenues."

The IOUs ..... The three major investor-owned electric utilities in California are PG&E, SCE and SDG&E. Their combined service areas cover approximately three-quarters of California's land area and their combined approximately 11 million bundled customer accounts represent approximately three-quarters of all retail connections in California. DWR sells power to the same bundled customers who are served by the three IOUs. See "THE DWR POWER SUPPLY PROGRAM – Customer Base."

Litigation and Administrative Proceedings ..... Litigation and administrative proceedings involving DWR or affecting DWR's Power Supply Program are summarized under "LITIGATION AND ADMINISTRATIVE PROCEEDINGS."

Certain Risk Factors ..... Investment in the Series 2008K Bonds is subject to certain risks, including the events and circumstances identified under "RISK FACTORS." Cross-references below are to subsections of "RISK FACTORS."

The occurrence of one or more of such events or circumstances described below and in "RISK FACTORS" could materially and adversely affect the ability of DWR to pay debt service on the Bonds.

- Failure of DWR's assumptions and projections in calculating its revenue requirements and a delay or failure in appropriations required for certain of DWR's administrative expenses (see "Certain Risks Associated with DWR's Power Supply Program");

- The insufficiency of Power Charge Revenues to pay amounts due under DWR's Priority Long-Term Power Contracts (including any termination payments), resulting in the use of Bond Charge Revenues for such purpose (see "Certain Risks Associated with DWR's Power Supply Program");

- Administrative or legal challenges to DWR's proceedings for establishing its revenue requirements or the CPUC's proceedings for calculating, revising and imposing Bond Charges and Power Charges, including particularly challenges to the inclusion of Priority Contract Costs in revenue requirement determinations (see "Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs");

- A court declining to give effect to the Rate Agreement in accordance with its literal terms, including the CPUC's Bond Charge Rate Covenant, if the effect of so doing would permit the recovery by DWR of power or bond costs that had been determined previously (in a legal challenge against DWR) not to be "just and reasonable" (see "Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs");

- The failure or refusal of one or more IOUs to perform under the Servicing Arrangements, including action or inaction by a bankrupt IOU (see "Collection of Bond Charges and Power Charges" and "Bankruptcy Risks");

- Uncertainties concerning changes in the electric industry and markets in the western states region (see "Uncertainties Relating to Electric Industry and Markets");

- Uncertainties concerning possible legislative, regulatory or other action affecting the Power Supply Program (see "Uncertainties Relating to Government Action");

- Actual results materially differing from the projections and assumptions contained in this Official Statement or contained in DWR's revenue requirements (see "Uncertainty of Projections and Assumptions"); and

- Uncertainties, disruptions or volatility in the financial markets, including but not limited to, credit or liquidity provider credit rating downgrades, swap provider credit rating downgrades, defaults under swap agreements, substantial fund flows into or out of the market for variable rate bonds, and other factors might affect market rates for variable rate bonds and the rates on DWR's variable rate bonds (see "Uncertainties of Financial Markets").

THE SERIES 2008K BONDS

General

The Series 2008K Bonds will be dated their date of delivery, will mature on the date and in the amounts, and will bear interest at the rates per annum shown on the inside cover of this Official Statement. Series 2008K Bonds may be purchased in book-entry form only, in principal amounts of $5,000 or any integral multiple thereof. Interest on the Series 2008K Bonds will be payable on May 1 and November 1 of each year, commencing November 1, 2008, to the owners of record at the close of business on the 15th day of the preceding calendar month (i) by check mailed by the Paying Agent to the registered Owner at such Owner's address as it appears on the books of registry required to be kept by the Registrar pursuant to the Indenture or (ii) by wire transfer to the account specified by the Owner of at least $1,000,000 in aggregate principal amount of Series 2008K Bonds in a written direction received by the Paying Agent at its office designated for such purpose on or prior to a Record Date (as defined in the Indenture). Any such direction or request shall remain in effect until revoked or revised by such Owner by an instrument in writing delivered to the Paying Agent. See APPENDIX B – "BOOK-ENTRY SYSTEM."

The Treasurer of the State is the Trustee and U.S. Bank National Association, is the Co-Trustee under the Indenture. The Treasurer of the State is also the Registrar and Paying Agent for the Series 2008K Bonds.

So long as any Series 2008K Bond is registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), procedures with respect to the transfer of ownership, and the payment of principal, Purchase Price, premium, if any, and interest on such Bond shall be in accordance with arrangements among DWR, the Trustee, the Co-Trustee, the Paying Agent and DTC. See APPENDIX B – "BOOK-ENTRY SYSTEM."

PLAN OF REFUNDING

Refunding of Prior Bonds

Refunding of Series 2005G-13 Bonds and Series 2005G-14 Bonds. The proceeds of the Series 2008K Bonds (the "Refunding Proceeds") will be applied to redeem all of the Outstanding variable rate demand bonds designated as Series 2005G-13 and Series 2005G-14. The Bonds being redeemed with Refunding Proceeds (the "Refunded Bonds") will be redeemed on May 8, 2008, at a redemption price equal to the principal amount thereof, plus accrued interest thereon.

DWR will use the Refunding Proceeds to pay the redemption price of the Refunded Bonds.

On April 23, 2008, DWR caused a notice of redemption to be delivered with respect to the Refunded Bonds. Such notice is conditional in that it is subject to the receipt by the Co-Trustee, as Paying Agent, for the Refunded Bonds, of money sufficient to pay the redemption price of the Refunded Bonds on or prior to the redemption date for the Refunded Bonds, all as set forth in such notice. The Refunding Proceeds, which will be deposited with the Co-Trustee and Paying Agent, are expected to satisfy such condition to redemption. Accordingly, upon issuance of the Series 2008K Bonds, the Refunded Bonds will be redeemed and will no longer be deemed to be Outstanding under the Indenture.

Series 2008H Bonds; Series 2008I Bonds; Series 2008J Bonds; Refunding of Series 2002D Bonds, Additional Series 2002C Bonds and Series 2005G Bonds. In addition to the Series 2008K Bonds, in 2008 DWR has issued the Series 2008H Bonds in an aggregate principal amount of $1,006,510,000 to refund the Series 2002D Bonds and a portion of the Series 2002C Bonds and the Series 2005G Bonds, has issued the Series 2008I Bonds in the principal amount of $150,000,000 to refund an additional portion of the Series 2002C Bonds, and has issued the Series 2008J Bonds in the principal amount of $330,000,000 to refund an additional portion of the Series 2005G Bonds. DWR's plan of refunding being implemented by the issuance of the Series 2008 Bonds is intended to reduce DWR's exposure to certain markets for bonds bearing interest at variable rates due to the volatility, uncertainty and disruption in such markets. Upon the issuance of the Series 2008 Bonds, approximately $9.5 billion of aggregate principal amount of Bonds will remain Outstanding, of which approximately $5.4 billion will bear interest at variable rates. The risk of interest rate volatility with respect to certain of the remaining Bonds bearing interest at variable rates has been hedged through the execution by DWR of certain interest rate swap agreements. See "THE DWR POWER SUPPLY PROGRAM – Financing of the Power Supply Program – *Interest Rate Hedges.*"

Estimated Sources and Uses of Funds

The estimated sources and uses of the proceeds of the Series 2008K Bonds at the time of issuance of the Series 2008K Bonds are as follows:

Estimated Sources of Funds	
Principal Amount of Bonds	$279,250,000.00
Net Original Issue Premium	18,302,966.00
Total Sources of Funds	$297,552,966.00
Estimated Uses of Funds	
Deposit in Escrow Account for Refunded Bonds	$295,621,628.42
Costs of Issuance	468,328.89
Underwriters' Discount	1,463,008.69
Total Uses of Funds	$297,552,966.00

SECURITY FOR THE BONDS

Introduction

The primary source of moneys for the payment of the Bonds and Bond Related Costs is Bond Charge Revenues, which constitutes part of the Trust Estate securing the Bonds, as described below. Bond Charges are imposed by the CPUC pursuant to the Rate Agreement and the Act upon customers in the service areas of the three IOUs.

The "Trust Estate" is assigned and pledged to the Trustees under the Indenture for the benefit of the Bonds and Parity Obligations, subject to the use of the Trust Estate in accordance with the Indenture. The "Trust Estate" is defined in the Indenture to include, among other things, "Revenues." "Revenues" includes both "Bond Charge Revenues" and "Power Charge Revenues." "Revenues" also includes revenues received by DWR from charges on customers of electric service providers, as described in "THE DWR POWER SUPPLY PROGRAM – Direct Access, Departing Load and Community Choice Aggregation." For a further description of the terms "Trust Estate" and "Revenues," see APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Definitions."

- "Bond Charge Revenues" are Revenues received by DWR arising from Bond Charges imposed by the CPUC upon customers in the service areas of the IOUs, including a Bond Charge component of the Cost Responsibility Surcharge imposed upon certain direct access customers and certain departing and Community Choice Aggregation load, as described in "THE DWR POWER SUPPLY PROGRAM – Direct Access, Departing Load and Community Choice Aggregation."

- "Power Charge Revenues" are Revenues received by DWR arising from Power Charges imposed by the CPUC upon customers in the service areas of the IOUs, including a Power Charge component of the Cost Responsibility Surcharge imposed upon certain direct access customers and certain departing and Community Choice Aggregation load, as described in "THE DWR POWER SUPPLY PROGRAM – Direct Access, Departing Load and Community Choice Aggregation."

The use of amounts on deposit in the Bond Charge Collection Account (including Bond Charge Revenues) for the payment of debt service on the Bonds and other Bond Related Costs when due is subject to the possible prior use of such amounts to pay "Priority Contract Costs" (defined to include costs and expenses under the Priority Long-Term Power Contracts described under "SECURITY FOR THE BONDS – Priority Long-Term Power Contracts") and under certain circumstances, expenses of the Trustees (see APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Events of Default and Remedies"). See also "SECURITY FOR THE BONDS – Accounts and Flow of Funds Under the Indenture," "SECURITY FOR THE BONDS – Priority Long-Term Power Contracts," and "RISK

FACTORS – Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs."

The accounts created under the Indenture and the flow of funds under the Indenture provide for the allocation of Revenues among different uses and are discussed below. See APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE" for a detailed discussion of security provisions for the Bonds.

THE BONDS SHALL NOT BE OR BE DEEMED TO CONSTITUTE A DEBT OR LIABILITY OF THE STATE OR OF ANY POLITICAL SUBDIVISION THEREOF OR A PLEDGE OF THE FAITH AND CREDIT OF THE STATE OR OF ANY SUCH POLITICAL SUBDIVISION, OTHER THAN DWR TO THE EXTENT PROVIDED IN THE INDENTURE. THE BONDS SHALL BE PAYABLE SOLELY FROM THE FUNDS PLEDGED THEREFOR PURSUANT TO THE INDENTURE. THE BONDS SHALL NOT DIRECTLY OR INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OR ANY POLITICAL SUBDIVISION THEREOF TO LEVY OR TO PLEDGE ANY FORM OF TAXATION WHATEVER THEREFOR OR TO MAKE ANY APPROPRIATION FOR THEIR PAYMENT.

Accounts and Flow of Funds under the Indenture

Revenues are held in and accounted for in the Electric Power Fund established under the Act for DWR. The Indenture establishes two sets of accounts for Revenues within the Electric Power Fund. On the following page is a simplified schematic representation of the flow of funds within the two sets of accounts (excluding the Administrative Cost Account).

One set of accounts is primarily for the deposit of Bond Charge Revenues and the payment of Bond Related Costs (collectively, the "Bond Charge Accounts"):

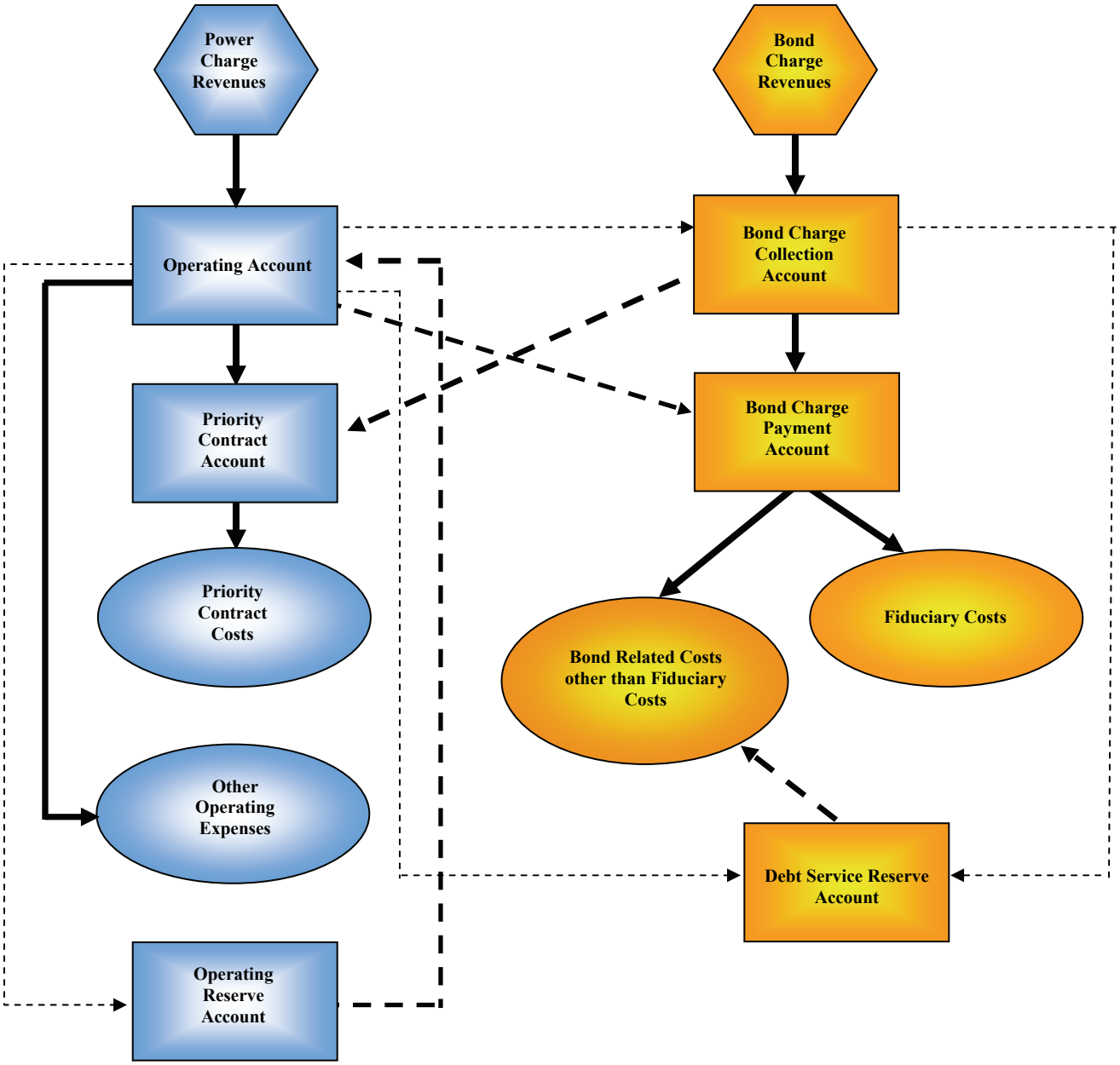
- the Bond Charge Collection Account,
- the Bond Charge Payment Account, and
- the Debt Service Reserve Account.

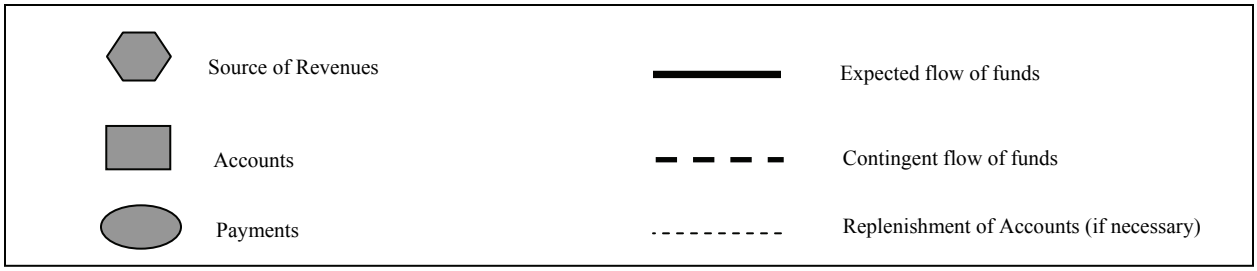
The other set of accounts is primarily for the deposit of Power Charge Revenues and the payment of operating expenses (including payments of Priority Contract Costs and other power purchase costs and other costs of the Power Supply Program) (collectively, the "Power Charge Accounts"):

- the Operating Account,
- the Priority Contract Account, and
- the Operating Reserve Account.

In addition, an Administrative Cost Account facilitates accounting for certain DWR administrative costs that are subject to appropriation, but this account has no effect on the use of Revenues.

Flow of Revenues under the Indenture*





*Simplified for graphic presentation purposes.

The Indenture requires all Bond Charge Revenues and any payments received from any counterparty to a Qualified Swap relating to Bonds to be deposited in the Bond Charge Collection Account, and all Power Charge Revenues and all other Revenues to be deposited in the Operating Account.

The Indenture requires the following transfers of Revenues to and from the Bond Charge Accounts:

- On or before the last Business Day of each month, DWR is required to transfer from the Bond Charge Collection Account to the Bond Charge Payment Account such amount as is necessary to make the amount in the Bond Charge Payment Account sufficient to pay Bond Related Costs (including "Debt Service" on the Bonds) estimated to accrue or be payable during the next succeeding three calendar months. For the definition of Debt Service, see APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Definitions." Each such transfer is subject to the prior transfer of amounts in the Bond Charge Collection Account to the Priority Contract Account if and to the extent amounts in the Priority Contract Account, the Operating Account and the Operating Reserve Account are insufficient to pay Priority Contract Costs then due under Priority Long-Term Power Contracts. See "SECURITY FOR THE BONDS – Priority Long-Term Power Contracts." Amounts in the Bond Charge Payment Account may be used solely to pay debt service on the Bonds and other Bond Related Costs.

- Deficiencies in the Bond Charge Payment Account are required to be made up *first*, from the Operating Account and *second*, from the Debt Service Reserve Account (except for Fiduciary costs).

- Each month after the Bond Charge Payment Account is funded as described above, Revenues are required to be transferred to the Debt Service Reserve Account, on a parity with payments for any reserve established for Parity Obligations, to the extent necessary to meet the respective requirements for such reserves. In the case of the Debt Service Reserve Account: (i) to the extent such transfer is required as a result of the use of Bond Charge Revenues for the payment of Priority Contract Costs or change in investment value, such transfers shall be made *first*, from the Operating Account and *second*, to the extent necessary, from the Bond Charge Collection Account, and (ii) if any other transfer is required, it shall be made from the Bond Charge Collection Account. Deficiencies in the Debt Service Reserve Account may be cured by monthly deposits during the period commencing no later than seven months following the determination of the deficiency, such that the deficiency is cured by no later than 12 months following the determination of the deficiency.

The Indenture requires the following transfers of Revenues to and from the Power Charge Accounts:

- On or before the fifth Business Day of each month, DWR is required to transfer from the Operating Account to the Priority Contract Account such amount as is necessary to make the amount in the Priority Contract Account sufficient to pay Priority Contract Costs estimated to be due during the balance of such month and through the first five Business Days of the next succeeding calendar month. Amounts in the Priority Contract Account may be used solely to pay Priority Contract Costs.

- Amounts in the Operating Account after the above transfer to the Priority Contract Account are to be used for the following purposes in the following order of priority:

  (i) for transfer to the Priority Contract Account if the amount therein is insufficient to pay Priority Contract Costs then due (that is, if the estimated amount previously transferred to that account turns out to be insufficient to pay actual Priority Contract Costs);

  (ii) for the payment of other Operating Expenses;

  (iii) to reimburse the Bond Charge Collection Account for any amounts previously transferred from the Bond Charge Collection Account to the Priority Contract Account to pay Priority Contract Costs;

  (iv) to pay debt service on the Bonds and other Bond Related Costs (if amounts in the Bond Charge Payment Account are not sufficient for those purposes) and, in addition, prior to the time Bond Charge Revenues are received in amounts sufficient to make the required transfers described above from the Bond Charge Collection Account to the Bond Charge Payment Account with respect to Bond Related Costs, amounts to make those transfers as required;

(v) for transfer to the Debt Service Reserve Account to the extent required by the Indenture as a result of the use of Bond Charge Revenues to pay Priority Contract Costs or a change in value of investments in the Debt Service Reserve Account;

(vi) to replenish the Operating Reserve Account to its requirement as provided by the Indenture;

(vii) to pay Subordinated Indebtedness and Subordinated Obligations and certain other amounts relating thereto; and

(viii) for any other lawful purpose of the Power Supply Program.

- The Operating Reserve Account may be drawn upon to make up any deficiency in the Operating Account for any of the purposes listed in clauses (i) through (v) of the preceding list, *provided, however,* that if and to the extent that the amount in the Operating Reserve Account is or would be less than or equal to the Priority Contract Contingency Reserve Amount, amounts in the Operating Reserve Account may be used only to make up any deficiency in the Priority Contract Account. See "SECURITY FOR THE BONDS - Operating Reserve Account."

The Indenture prescribes an application of Revenues that may be different than as described above in the event of a default thereunder. See APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Events of Defaults and Remedies."

Debt Service Reserve Account

The "Debt Service Reserve Requirement" is an amount equal to maximum aggregate annual Debt Service on all outstanding Bonds, determined in accordance with the Indenture. The Debt Service Reserve Account was initially funded with proceeds of Bonds issued in 2002 and is required to be maintained in the amount of the Debt Service Reserve Requirement. Giving effect to the issuance of the Series 2008K Bonds, the Debt Service Reserve Account Requirement will be $917,280,782. The Debt Service Reserve Account is required to be replenished, if necessary, from Power Charge Revenues or Bond Charge Revenues in the manner and at the times (to commence no later than seven months following the determination of the deficiency and curing such deficiency by no later than 12 months following the determination of the deficiency) described under APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Application and Flow of Funds – *Debt Service Reserve Account*."

For an explanation of assumptions to be used in calculating the Debt Service Reserve Requirement for variable rate and hedged bonds and under other circumstances, see the definitions of Debt Service and Debt Service Reserve Account in APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Definitions."

Alternate Debt Service Reserve Account Deposits may be made to the Debt Service Reserve Account in lieu of cash and/or securities. Such Deposits may consist of irrevocable surety bonds, insurance policies, letters of credit or similar obligations.

Whenever the amount in the Debt Service Reserve Account exceeds the Debt Service Reserve Requirement, after giving effect to any Alternate Debt Service Reserve Account Deposit, the excess shall, at least annually, be transferred to the Bond Charge Collection Account.

Amounts in the Debt Service Reserve Account may be used for the payment of Bond Related Costs (including debt service on the Bonds, payments under Enhancement Facilities and scheduled and termination payments under Qualified Swaps) except Fiduciary costs, and in each case only if amounts in the Bond Charge Payment Account and Operating Account are insufficient for that purpose. See APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Application and Flow of Funds – *Debt Service Reserve Account*."

Operating Account

DWR has covenanted in the Indenture to include in its revenue requirements amounts estimated to be sufficient, among other things, to cause the amount on deposit in the Operating Account (excluding any reserves established for any Subordinated Indebtedness or Subordinated Obligations), at all times during any calendar month, to equal the Minimum

Operating Expense Available Balance. "Minimum Operating Expense Available Balance" means, at the time revenue requirements are submitted to the CPUC, the maximum amount projected by DWR by which Operating Expenses exceed Power Charge Revenues during any one calendar month during that revenue requirement period, based on such assumptions as DWR deems to be appropriate after consultation with the CPUC and taking into account a range of possible future outcomes.

Operating Reserve Account

The Operating Reserve Account has been established in case the amount in the Operating Account is insufficient to pay certain expenses, including any Priority Long-Term Power Contract termination payments, any other Priority Contract Costs and any of the other expenses listed in clauses (i) through (v) of the list of monthly Operating Account transfers set forth above under "SECURITY FOR THE BONDS - Accounts and Flow of Funds under the Indenture." If the amount in the Operating Account is insufficient to pay Priority Contract Costs of any kind, the Operating Reserve Account is required to be exhausted before the Bond Charge Collection Account is utilized for such purpose. If the amount in the Operating Reserve Account is less than or equal to the Priority Contract Contingency Reserve Amount, amounts in the Operating Reserve Account may only be used to make up any deficiency in the Priority Contract Account. The "Priority Contract Contingency Reserve Amount" is to be calculated at the beginning of each revenue requirement period and is the maximum monthly amount of Priority Contract Costs projected by DWR to be payable under Priority Long-Term Power Contracts during that revenue requirement period, based on such assumptions as DWR deems to be appropriate, taking into account a range of possible future outcomes.

The "Operating Reserve Account Requirement" is an amount, during each revenue requirement period, equal to the greater of (1) the largest aggregate amount, as projected by DWR, by which Operating Expenses exceed Power Charge Revenues during any seven calendar month period commencing in that revenue requirement period, and (2) 12 percent of DWR's projected annual operating expenses; *provided, however,* that solely for purposes of (2) above, the projected amount shall not be less than the applicable percentage of DWR's operating expenses for the most recent 12 calendar month period for which DWR determines that reasonably full and complete operating expense information is available, adjusted for reductions in DWR financial responsibility for power supply contracts. Projections may be based on such assumptions as DWR deems to be appropriate and, in the case of clause (1) above, may take into account a range of possible future outcomes. Whenever the Indenture requires DWR to consult with the CPUC with respect to assumptions made by DWR, DWR is required to involve the CPUC in the development of those assumptions by conferring regularly in a manner consistent with DWR's obligations under Article 4 of the Rate Agreement. The Operating Reserve Account is required to be replenished, if necessary, from Power Charge Revenues in the manner and at the times (which may extend over a period of one year commencing seven months following the determination of the deficiency) described in APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Application and Flow of Funds – *Operating Reserve Account*."

Whenever the Operating Reserve Account Requirement is reduced pursuant to the Indenture, any excess amounts in the Operating Reserve Account ("Excess Amounts") will be used at such time to satisfy any deficiencies existing at such time in the transfers, applications and withdrawals described in clauses (i) through (v) of the list under "SECURITY FOR THE BONDS - Accounts and Flow of Funds under the Indenture" above. Unless otherwise agreed by both DWR and the CPUC, each acting in its own discretion, any Excess Amounts remaining after application to the uses described in the preceding sentence shall be used, at the direction of the CPUC after consultation with DWR, to (i) adjust DWR charges or (ii) with the agreement of DWR, to reduce debt outstanding under the Indenture, in all instances upon consideration of the interests of the customers of the IOUs and of DWR and, if applicable, electric service provider retail customers. If and when DWR no longer is responsible for the payment of costs under any Power Supply Contract, the balance, if any, in the Operating Reserve Account is required to be applied as described in the preceding two sentences.

Bond Related Costs

Bond Related Costs that are payable from Bond Charges imposed by the CPUC under the Rate Agreement consist of payments or deposits or other provision to be made by DWR under the Indenture or other financing documents or the Act, for the following components of DWR's revenue requirements under the Act:

(i) principal of, premium, if any, and interest on Bonds and any additional amount required under the Indenture or other financing documents to be deposited into the Bond Charge Collection Account to provide debt service coverage of the Bonds;

(ii) payments required to be made (A) under agreements with issuers of credit and liquidity facilities and their participants, including letters of credit, bond insurance, guarantees, debt service reserve fund surety bonds, lines of credit, reimbursement agreements, and standby bond purchase agreements, (B) under agreements relating to other financial instruments entered into in connection with the Bonds, including but not limited to investment agreements, hedges, interest rate swaps, caps, options and forward purchase agreements, and (C) under agreements relating to the remarketing of Bonds, including but not limited to remarketing agreements, dealer agreements and auction agent agreements;

(iii) deposits to the Debt Service Reserve Account established under the Indenture to the extent necessary to provide therein an amount equal to the requirement for such account under the Indenture and other financing documents if not otherwise replenished from Power Charges;

(iv) the costs of the Trustees and the Registrars and Paying Agents associated with the issuance and administration of the Bonds; and

(v) when and if DWR no longer sells Power under the Act and Bonds remain outstanding, DWR's Bond Charge servicing costs, costs of preparing and providing the information and reports required under the Indenture and other financing documents, the Rate Agreement and the Act, related audit, legal and consulting costs, related administrative costs, and costs of complying with arbitrage restrictions and rebate requirements.

The amount payable under Parity Obligations is not limited by the Indenture or the Rate Agreement. However, not all costs that constitute Bond Related Costs under the Rate Agreement are payable on a parity with the Bonds. "Parity Obligation" is defined in the Indenture to include only "Reimbursement Obligations" and the amounts payable under Qualified Swaps. The criteria for determining whether an agreement is a Reimbursement Obligation or a Qualified Swap are explained in APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Special Provisions Relating to Enhancement Facilities, Qualified Swaps, Other Similar Arrangements and Interim Financing Notes."

In connection with the issuance of the Series 2002 Bonds and the Series 2005 Bonds, DWR entered into agreements with providers of credit enhancement and liquidity facilities and with interest rate swap providers, which constitute Parity Obligations. See "THE DWR POWER SUPPLY PROGRAM – Financing of the Power Supply Program."

Rate Covenants

The CPUC has irrevocably covenanted in the Rate Agreement, for the benefit of Bondholders (and all other persons to whom DWR is obligated to pay Bond Related Costs), to calculate, revise and impose from time to time, Bond Charges sufficient to provide moneys so that amounts available for deposit in the Bond Charge Payment Account under the Indenture from time to time, together with amounts on deposit in the Bond Charge Payment Account, are at all times sufficient to pay or provide for the payment of debt service on the Bonds and all other Bond Related Costs (as defined in the Rate Agreement) when due in accordance with the Indenture and other financing documents. See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – Rate Agreement." The Rate Agreement provides that this covenant shall have the force and effect of a "financing order" under the California Public Utilities Code and shall be irrevocable and enforceable in accordance with its terms, including, without limitation, in circumstances in which DWR has breached its obligations under the Rate Agreement or in respect of the Financing Documents. Under the California Public Utilities Code, a "financing order" is binding upon the CPUC as it may be constituted from time to time, and the CPUC shall have no authority to rescind, alter or amend its obligations thereunder. Under the Act, the rights, powers and duties of the CPUC may not be diminished or impaired in a manner that would adversely affect the interests or rights of Bondholders. See "SECURITY FOR THE BONDS – Bond Related Costs." See also, however, "RISK FACTORS – Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs."

DWR has covenanted in the Indenture to cause to be established, fixed and revised from time to time, charges sufficient, together with any other available moneys and securities on deposit in DWR's Electric Power Fund, to satisfy all of DWR's revenue requirements at the times and in the amounts needed. The term "revenue requirements" means the amounts needed from time to time by DWR to satisfy its obligations under the Act and under proclamations and orders issued pursuant to the California Emergency Services Act. These obligations include, but are not limited to, making deposits to the

Bond Charge Payment Account and Debt Service Reserve Account in the amounts and at the times required by the Indenture. See APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE."

Priority Long-Term Power Contracts

General

The Priority Long-Term Power Contracts each provide, in effect, that payments by DWR under the contracts are to be paid or are payable prior to bonds, notes, or other indebtedness of DWR secured by a pledge or assignment of the revenues of DWR under the Act and other amounts in the Electric Power Fund established by the Act. Substantially all of the power purchased by DWR under the Act will be purchased under Priority Long-Term Power Contracts and for that reason substantially all operating expenses will be Priority Contract Costs. See also "THE DWR POWER SUPPLY PROGRAM – Power Purchase Contracts."

Under the Rate Agreement, the term "Priority Long Term Power Contracts" is defined as (i) those long-term electric power contracts identified in the appendix to the Rate Agreement and not including any electric power contracts entered into after August 14, 2001, *provided, however,* that such term includes any priority long-term electric power contract entered into after such date as an amendment or novation of any Priority Long-Term Power Contract, and (ii) any contracts entered into for the purpose of securing fuel for use at generating facilities being operated pursuant to such Priority Long-Term Power Contracts, if that fuel supply contract contains a provision to the general effect that payments by DWR under the contract are to be paid or payable prior to bonds, notes or other indebtedness of DWR secured by a pledge or assignment of the revenues of DWR under the Act and other amounts in the Electric Power Fund. The Indenture incorporates by reference the Rate Agreement's definition of that term.

The Priority Long-Term Power Contracts obligate DWR to purchase power from various suppliers. The Priority Long-Term Power Contracts currently have varying terms as shown in the table titled "Projected Annual Energy (MWh) From DWR Power Contracts." See "THE DWR POWER SUPPLY PROGRAM – Power Purchase Contracts – *Description of DWR's Power Contracts*." The total amount of energy purchased by DWR through the Priority Long-Term Power Contracts has been, from time to time, together with the energy available from IOU sources, in excess of bundled customer load, and such excesses are expected to continue to recur from time to time. In these periods, surplus energy has been and will continue to be sold to other users. DWR expects that from time to time the price it receives for surplus energy sales will be less than its cost for that energy. If any such losses are substantially greater than projected by DWR in its then-current revenue requirement calculation, the submission of a revised revenue requirement and the imposition of increased Power Charges could be required. See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES.

If a counterparty under a Priority Long-Term Power Contract fails to deliver power to DWR, whether such counterparty is contractually permitted to do so, financially unable to perform its obligations thereunder or unable to deliver power for any other reason, one or more IOUs would have to purchase replacement power because DWR is no longer authorized to enter into new power purchase contracts. If the failed deliveries occur under a contract providing for power at a cost lower than DWR's cumulative average cost (and sufficient mark-to-market termination payments are not owed, are not paid or are delayed for any reason), DWR could experience significant cash flow deterioration during the period required for DWR to submit a revised revenue requirement and for the CPUC to raise Power Charges to meet that revised revenue requirement.

Payment Priority

The use of amounts on deposit in the Bond Charge Collection Account (including Bond Charge Revenues) for the payment of debt service on the Bonds and other Bond Related Costs when due is subject to the possible prior use of such amounts to pay Priority Contract Costs. See "SECURITY FOR THE BONDS - Accounts and Flow of Funds Under the Indenture." To date, it has not been necessary to use Bond Charge Revenues to pay Priority Contract Costs because Power Charge Revenues have been adequate to pay all Priority Contract Costs as and when due. Although no assurances can be given, DWR expects the calculation, imposition and collection of Power Charge Revenues to continue to be adequate to pay all Priority Contract Costs as and when due and does not expect to use Bond Charge Revenues to pay Priority Contract Costs. See "SECURITY FOR THE BONDS - Recovery of Amounts Used to Pay Priority Contract Costs." See also "RISK FACTORS – Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs."

If Bond Charge Revenues and other amounts on deposit in the Bond Charge Collection Account are used to pay Priority Contract Costs, the Rate Agreement provides that DWR shall take such actions as are required under the Rate Agreement so that the amounts applied from the Bond Charge Collection Account for such purpose shall be replenished from Power Charges. See "SECURITY FOR THE BONDS - Recovery of Amounts Used to Pay Priority Contract Costs."

In the absence of material change in the net per unit cost of energy derived from Priority Long-Term Power Contracts and provided to DWR's retail customers and in the absence of material termination payments on Priority Long-Term Power Contracts, Power Charge Revenues are expected to increase and decrease approximately in proportion to increases and decreases in Priority Contract Costs. Furthermore, the timing of monthly payments of Priority Contract Costs (an average lag of about 35 days from provision of energy) is comparable to the timing of receipt by DWR of Power Charge Revenues (an average lag of about 45 days from consumption of energy).

However, a number of factors affect the variability of net per unit Priority Contract Costs from time to time, and, as a result, the sufficiency of the monthly amount of Power Charge Revenues in relation to the monthly amount of Priority Contract Costs. These factors include, but are not limited to, the cost from time to time of natural gas, the amount of surplus power from Priority Long-Term Power Contracts sold at prices below the price paid for such power, and the amount of power dispatched from time to time under contracts with fixed capacity payments or with adjustment rights on block quantities. In the course of preparing its revenue requirement determinations, DWR evaluates several cash flow scenarios that make varying assumptions concerning these factors. See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – Substantive Considerations in Establishing Revenue Requirements."

Termination Payments

In addition, most of the Priority Long-Term Power Contracts provide for the payment of termination liquidated damages by DWR upon the occurrence of an event of default by DWR and termination of the Priority Long-Term Power Contract by the seller. The principal risk of termination is the failure of DWR to pay for purchased power, a Priority Contract Cost which is payable in the short term from the Operating Account, the Operating Reserve Account and, if necessary, the Bond Charge Collection Account, and payable in the longer term from increased Power Charges. See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES."

The termination liquidated damages are generally equal to the net present value of the difference between the price for power pursuant to the Priority Long-Term Power Contract and the then-current market price for power, for the entire remaining term of the Priority Long-Term Power Contract (referred to herein as the "mark-to-market value"). A portion of DWR's Priority Long-Term Power Contracts currently have a positive mark-to-market value, while others have a negative mark-to-market value. The mark-to-market values of the Priority Long-Term Power Contracts change daily with wholesale power prices, and no assurance can be given that DWR will not have substantial contingent mark-to-market liabilities with respect to its Priority Long-Term Power Contracts in the future. Upon a DWR default under one or more Priority Long-Term Power Contracts with a negative mark-to-market value, DWR could incur termination payment liabilities in the hundreds of millions of dollars or greater. Under most of the Priority Long-Term Power Contracts, termination payments are due within 180 days of any termination and would constitute Priority Contract Costs recoverable from Power Charges. DWR revenue requirements and projected Power Charge Account balances are not established to specifically address contract terminations. If a termination were to occur, DWR might need to submit a revised revenue requirement to address the change in expected costs and energy deliveries, and the CPUC would need to act to set Power Charges that reflect the revised revenue requirement. See "SECURITY FOR THE BONDS" and "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES."

Operating Reserve Account

The Indenture requires the Operating Reserve Account to be established and maintained by DWR at an amount equal to the Operating Reserve Account Requirement, which may be based on such assumptions as DWR deems to be appropriate, after consultation with the CPUC, and taking into account a range of possible future outcomes. See "SECURITY FOR THE BONDS – Operating Reserve Account." When establishing the Operating Reserve Requirement from time to time, DWR intends to utilize assumptions and take into account possible future outcomes that include a range of variation in the circumstances that affect the factors described in the foregoing paragraph.

Certain Litigation

Litigation is pending between DWR and one of its long-term power suppliers. See "THE DWR POWER SUPPLY PROGRAM – Power Purchase Contracts – *Dispute with Power Supplier*."

Recovery of Amounts Used to Pay Priority Contract Costs

The Indenture and the Rate Agreement permit Bond Charge Revenues to be used to pay Priority Contract Costs if other funds under the Indenture, such as Power Charge Revenues, are insufficient. The flow of funds required by the Indenture provides that Priority Contract Costs are to be paid each month from Power Charge Revenues before any payment or funding of any other Department Costs. See "SECURITY FOR THE BONDS – Accounts and Flow of Funds under the Indenture." The CPUC has covenanted in the Rate Agreement to calculate, revise and impose, from time to time, Power Charges sufficient to provide moneys in the amounts and at the times necessary to satisfy the Retail Revenue Requirements submitted by DWR to the CPUC in accordance with the Rate Agreement. The Rate Agreement provides that in the event Priority Contract Costs are funded out of the Bond Charge Collection Account, DWR shall take such actions as are required under the Rate Agreement so that the amounts applied from the Bond Charge Collection Account for such purpose shall be replenished from Power Charges. See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – Rate Agreement" and "RISK FACTORS – Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs."

CALIFORNIA DEPARTMENT OF WATER RESOURCES

General

DWR is a department within the Resources Agency of the Executive Branch of the State. DWR was established in 1956 under California law for the purpose of planning and guiding the development of California's water resources. In addition to responsibility for the Power Supply Program, DWR is separately responsible for the planning, construction, operation and maintenance of the State Water Project, a statewide system of dams, reservoirs, pumping plants, power plants and aqueducts. DWR is the largest purchaser of power for its own use within California because of the power requirements of the State Water Project, and DWR was designated by Governor Davis to undertake the Power Supply Program because of DWR's experience in purchasing and selling power. The Power Supply Program is not part of the State Water Project, the revenues of the State Water Project are not available for the payment of the Bonds, and the Trust Estate pledged for the payment of the Bonds is not available for the payment of indebtedness incurred for the State Water Project.

The Director of Water Resources oversees DWR's activities, with the assistance of a Chief Deputy Director and four Deputy Directors. The Director and Chief Deputy Director are appointed by the Governor and report to the Governor through the Secretary of the Resources Agency. Biographical information for the DWR management officials currently responsible for the Power Supply Program is as follows.

Lester A. Snow has served as the Director of Water Resources since February 2004. Mr. Snow has more than 25 years of experience in public water resource management, including, but not limited to, serving as the Mid-Pacific Regional Director of the U.S. Bureau of Reclamation, the Executive Director of the CALFED Bay-Delta Program, the General Manager of the San Diego County Water Authority and the Tucson Area Director of the Arizona Department of Water Resources.

David Sandino has served as Chief Counsel of DWR since 2007. He oversees a staff of 27 attorneys working on DWR's varied and complex legal issues. Prior to his appointment as Chief Counsel, he served as lead counsel for the California Reclamation Board. He represented DWR in the Sacramento-San Joaquin Bay Delta Hearings from 1995-2000.

Perla Netto-Brown is the Chief Financial Officer of DWR. Prior to joining DWR, Ms. Netto-Brown was employed by the California Auditor General. She joined DWR in 1986, has served in various capacities in the Division of Fiscal Services and was named Chief of the Division of Fiscal Services in 2000.

Timothy Haines is the Deputy Director of DWR responsible for the Power Supply Program. Prior to his appointment as Deputy Director, he served as a consultant to DWR during the energy crisis of 2000/2001 and as Special Assistant to the Chair of the California Independent System Operator ("CAISO") following a 15 year career with the Sacramento Municipal Utility District.

John Pacheco is the Energy Commodity Manager for the Power Supply Program. He develops, recommends and implements energy policy. He began his career with DWR in 1978. In February 2001, he joined the Power Supply Program and played a prominent role in growing the organization that helped stabilize the Western power markets. He began his career with DWR in 1978.

James E. Olson is the Chief, Financial Management Office, Power Supply Program. He was an audit partner with a national accounting firm prior to joining DWR as Deputy Controller in 1993 with responsibility for management of general accounting and financial reporting. He was assigned responsibility for the financial operations of the Power Supply Program in January 2001.

CALIFORNIA PUBLIC UTILITIES COMMISSION

The CPUC is the principal ratemaking authority for the IOUs' retail rates. Under the Rate Agreement, the CPUC has agreed to impose Bond Charges sufficient to provide moneys sufficient to pay all Bond Related Costs when due, and to impose Power Charges sufficient to satisfy DWR's "Retail Revenue Requirements" (defined in the Rate Agreement attached as Appendix D) as specified by DWR. Pursuant to the Act, the CPUC also issues orders approving Servicing Arrangements or otherwise directing the IOUs to provide operational, transmission, distribution, billing, collection and other services to DWR in connection with the Power Supply Program.

The CPUC consists of five members appointed by the Governor and confirmed by the Senate. Members serve for six-year, staggered terms. The Governor appoints one of the five to serve as President. The CPUC is an independent regulatory agency. It regulates the IOUs and other California entities, mostly investor-owned electric, telecommunications, natural gas, water, railroad and passenger transportation companies. Some of the entities regulated by the CPUC are not investor-owned. The CPUC's headquarters are in San Francisco.

Since January 1, 2001, the CPUC has adopted a number of decisions that relate to DWR's Power Supply Program. Additional CPUC decisions relating to the Power Supply Program and the Bonds are expected by DWR. See "THE DWR POWER SUPPLY PROGRAM – Collection of Revenues" and " – Direct Access, Departing Load and Community Choice Aggregation" and "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES."

The CPUC makes no representation as to the accuracy or completeness of this Official Statement, including any forward-looking statements or projections contained in this Official Statement and any description in this Official Statement of litigation involving or affecting the CPUC. Any statements regarding such litigation do not necessarily represent the CPUC's view of such litigation or any position in such litigation. In addition, while CPUC staff may have assisted in the preparation of certain sections of this Official Statement, the CPUC can only take positions through formal action and has not taken any such action or approved this Official Statement. The CPUC is an independent five member body that must act by an affirmative vote of a majority of its members and, as a result, the CPUC can only indicate its views in formal decisions or other formal actions. In addition, the CPUC is an independent body not subject to the control of DWR and may take positions in the future different from DWR in litigation, or other matters described in this Official Statement. As a result, statements in this Official Statement regarding electricity markets and regulation, and DWR's views of the CPUC's role or DWR's role in such markets and regulation, do not necessarily represent the views, opinions or beliefs of the CPUC and should not be construed as such by any recipient of this Official Statement.

THE DWR POWER SUPPLY PROGRAM

Background and History

Summary of the Power Supply Program

Under the Power Supply Program, DWR purchases power from wholesale suppliers under long-term contracts, and sells electricity to retail customers that are also served by the IOUs. DWR electricity is delivered to retail customers through the transmission and distribution systems of the IOUs. DWR's costs are recovered through Bond Charges and Power Charges imposed on retail customers. Payments from customers are collected by the IOUs pursuant to Servicing Arrangements approved or ordered by the CPUC.

Electricity Service in California

Prior to the inception of the DWR Power Supply Program, Californians generally received their electricity service from one of three types of providers: IOUs, local publicly owned electric utilities, and electric service providers.

IOUs have a defined geographic service area and are required by law to serve customers in that area. The CPUC regulates the IOUs' rates and how electricity service is provided to their customers.

Publicly owned electric utilities are public entities that provide electric service to residents and businesses in their local area. Unlike IOUs, they are not regulated by the CPUC. Major publicly owned electric utilities include the Los Angeles Department of Water and Power, the Sacramento Municipal Utility District, and the Imperial Irrigation District.

The electric service providers provide retail electricity service to customers who have chosen not to receive electricity service from the utility that serves their area. Instead, these customers have entered into "direct access" contracts with electric service providers for their electricity. This electricity is delivered to these electric service provider customers through the transmission and distribution system of their local utility. There are currently sixteen registered electric service providers operating in the State, generally serving large industrial and commercial businesses. The electric service providers also provide electricity to certain State and local government entities, such as the California State University system, several University of California campuses, some community college districts, and some local school districts.

Since the inception of the Power Supply Program, IOU customers have purchased a portion of their electricity from the IOUs and the remainder from DWR. Currently, the IOUs and DWR provide approximately 68 percent of the electricity in the State; publicly owned electric utilities provide 22 percent; and electric service providers and others provide 10 percent.[*]

Deregulation and Direct Access

California began the process of restructuring electricity service in the early 1990s by introducing competition into the generation of electricity, with the ultimate goal being lower prices for IOU customers. The deregulation legislation ultimately enacted in 1996 ("AB 1890") included a "transition" period during which the IOUs were to sell off their fossil fuel power plants to independent generators while retaining their hydroelectric and nuclear power plants. Eventually, however, electricity purchases and customer rates were to be determined in a competitive market. In such a market, customers could choose to have the IOUs purchase the electricity on their behalf, or they could purchase electric power directly from electric service providers through direct access. During the transition period, however, the retail rates of the IOUs were to be frozen until certain conditions had been satisfied, including the recovery by the IOUs of certain "stranded" costs of uneconomic generating facilities that would not be otherwise recoverable in a competitive market. The deregulation process was suspended in response to the energy crisis that arose in 2000 and early 2001.

The California Energy Crisis

By the summer of 2000, wholesale power sellers were not making sufficient power supplies available in the wholesale spot market, and spot market prices began to rise, swiftly and dramatically. At the same time, PG&E and SCE remained in the AB 1890 transition period, with frozen retail rates. The cost of procuring power in the spot market quickly surpassed the frozen retail rates. By December 2000, PG&E and SCE had incurred several billion dollars of losses, adversely affecting their creditworthiness and ultimately causing defaults in payments for power purchases in the spot markets and from other suppliers. PG&E's and SCE's credit deterioration had a spiraling effect, deterring power suppliers from bidding supplies into the California market, exacerbating the shortage of electric power, and causing wholesale prices to escalate further. In the SDG&E service area, retail rates had been unfrozen by the time wholesale spot market prices began escalating in 2000. SDG&E's retail rates escalated sharply with wholesale prices, causing the State Legislature to enact a statutory cap on retail rates in the San Diego area.

The State's Response to the Energy Crisis: the DWR Power Supply Program

Recognizing an immediate need for a creditworthy party to assume the obligation of purchasing electricity for customers of the IOUs, Governor Gray Davis proclaimed a state of emergency on January 17, 2001 and authorized DWR to begin purchasing the electricity that the IOUs could not provide (such portion being referred to herein as the "net short").

[*] Source: California Energy Commission's 2007 Integrated Energy Policy Report CEC-100-2007-008-CMF.

Thereafter, the State Legislature passed, and Governor Davis signed, Assembly Bill 1 ("AB 1X"). AB 1X authorized DWR to undertake a program of purchasing the net short for customers of the IOUs, incurring debt to finance such purchases, implementing a mechanism to recover the costs thereof from the ratepayers of the IOUs, and related actions. Such program is referred to herein as the "Power Supply Program."

At the height of the emergency in 2001, DWR began purchasing substantial amounts of power in daily and even hourly transactions on the spot market, and under other short-term contracts. In addition, DWR solicited proposals for, negotiated and entered into long-term power purchase contracts, which had the effect of reducing the amount of power DWR purchased on the spot market. From January 2001 through December 2002, DWR procured the entire net short for the three IOUs from power delivered under its long-term power purchase contracts and from wholesale spot market and other short-term transactions. The Act does not authorize DWR to enter into new power purchase contracts after December 31, 2002. As a result, DWR ceased procuring the portion of the net short not provided by the long-term power purchase contracts in effect as of such date (such portion being referred to herein as the "residual net short"), and each of the IOUs resumed procuring the residual net short for its respective bundled customers. As DWR's existing long-term contracts expire or are otherwise terminated, the IOUs are responsible for procuring replacement power until such time as the entire load of bundled customers is provided by the IOUs. While these developments have reduced DWR's Retail Revenue Requirements, it had no direct effect on Bond Charges. Irrespective of whether DWR continues to purchase or sell electricity under the Power Supply Program, the Rate Agreement obligates the CPUC to continue to impose Bond Charges in an amount sufficient to pay Bond Related Costs when due. See "SECURITY FOR THE BONDS – Rate Covenants."

Also effective January 1, 2003, each of the IOUs assumed operational (but not financial) responsibility for a portion of DWR's portfolio of long-term power contracts. Accordingly, each IOU is now responsible for scheduling the electricity produced or delivered under the contracts allocated to it by the CPUC. Although the IOUs have assumed operational responsibility, DWR remains financially responsible for the payment obligations under such contracts. The costs of these contracts are recovered through Revenues that are deposited in the Power Charge Account; and the portion to be paid by the retail customers in each IOU's service territory is determined by a cost allocation methodology ordered by the CPUC.

In response to the energy crisis, the State also halted several aspects of deregulation. Among these, the State prevented the IOUs from continuing to sell their power plants and suspended the ability for bundled customers to enter into new direct access contracts. Under existing law, this suspension will continue until DWR no longer supplies power under the long-term electricity contracts. DWR expects the last of DWR's power purchase contracts to expire in 2015. See the table titled "Projected Annual Energy (MWh) From DWR Power Contracts under the caption "THE DWR POWER SUPPLY PROGRAM – Power Purchase Contracts – *Description of DWR's Power Contracts*."

Statutory Authority

AB 1X was codified as Division 27 of the California Water Code (commencing with Section 80000), and is also referred to herein as the "Act." The Act established a framework under which DWR would purchase the net short and would recover the costs of the Power Supply Program. The Act authorized DWR to contract for power under such terms and conditions as it deemed appropriate, taking into account a number of factors, including a desire to secure as much low-cost power as possible under contract. Although the Act only authorized DWR to enter into new power purchase contracts until December 31, 2002, the Act permits DWR to continue administering its contract portfolio after that date. See "THE DWR POWER SUPPLY PROGRAM – Pending Legislation." Under the Act, power acquired by DWR is sold directly to customers in the service areas of the IOUs, and payment for such power is a direct obligation of the customers. The Act provides that DWR is entitled to recover its costs, including power purchase costs and debt service on the Bonds (referred to herein as DWR's "revenue requirements"), in the amounts and at the times necessary to satisfy its contractual obligations, and is to advise the CPUC of its revenue requirements so that its revenue requirements can be recovered through charges imposed upon customers by the CPUC. The Act also authorized the CPUC and DWR to enter into agreements with respect to such charges. The Act authorizes DWR to contract with the IOUs for the transmission and distribution of its power, and for billing, collection and related services, all as agents of DWR. The Act also directs the CPUC, at the request of DWR, to order the IOUs to provide such services. The Act provides for the suspension of the right of customers to purchase their power from energy providers other than the IOUs and DWR, so long as DWR continues to provide power. See "THE DWR POWER SUPPLY PROGRAM – Direct Access, Departing Load and Community Choice Aggregation."

The Act also authorized DWR to issue up to $13,423,000,000 principal amount of bonds to provide permanent financing for costs incurred in connection with the Power Supply Program (excluding bond anticipation notes and refunding bonds issued to obtain lower interest rates). The Series 2002 Bonds were issued pursuant to this authorization in the

aggregate principal amount of $11,263,500,000. The Series 2005 Bonds were issued pursuant to the Act to obtain lower interest rates and were not subject to the principal amount limitations of the Act. The Series 2008 Bonds are authorized by the Act, but as yet no determination has been made as to whether all or any portion of the Series 2008 Bonds will be treated as having been issued to obtain lower interest rates.

No action or approval by the Federal Energy Regulatory Commission ("FERC") or any other federal agency is required for the issuance of the Bonds or the calculation, revision, imposition or collection of Bond Charges or Power Charges.

Pending Legislation

On March 3, 2008, a bill identified as AB 3058 was introduced in the California Assembly by the Committee on Utilities and Commerce. As amended on April 8, 2008, the bill proposes to amend Section 80110 of the Act to provide that for any contract for the purchase of power by the Department pursuant to the Act that is modified or renegotiated after December 31, 2007, the CPUC shall determine whether the cost and administration of the proposed modification or renegotiation is just and reasonable. The bill would further provide that for this purpose, a contract is "modified or renegotiated" if there is any material change in the terms of the contract, including an extension, novation, or assignment. The Department believes that none of its power purchase contracts have been modified or renegotiated within the meaning of this proposed provision since December 31, 2007.

Power Purchase Contracts

General

Since December 31, 2002, DWR's power purchase activities under the Power Supply Program have been limited to purchasing power from wholesale suppliers under the 32 long-term power purchase contracts then in effect. As a result, the current operating expenses of the Power Supply Program are primarily power purchase costs under such long-term contracts, including associated fuel procurement costs. As described in "THE DWR POWER SUPPLY PROGRAM – Background and History," responsibility for managing the remaining power purchase contracts has been largely transferred to the IOUs, although DWR continues to perform certain administrative activities with respect to the contracts, and remains financially responsible for payments under the contracts. In addition, DWR has a continuing role in the procurement and risk management of fuel requirements for the contracts. The IOUs also advise on fuel procurement, but DWR maintains financial and ultimate operational responsibility for this function.

DWR has renegotiated 19 of the original contracts that were entered into in 2001 and that will remain in effect in 2008 or beyond. DWR has terminated five additional contracts for cause. DWR continues to monitor its contracts and determine if there are opportunities for bilateral renegotiation, which could lead to more favorable power supply terms and costs. See "THE DWR POWER SUPPLY PROGRAM – Pending Legislation." DWR has the right to terminate one or more of its remaining contracts, but the contracts each provide that if the contract is terminated for reasons other than breach or default by the power-supplying counterparty to the contract, DWR would be obligated to pay generally the mark-to-market value of the contract, typically within 180 days of termination. Any such termination other than for an uncured default or breach by the seller would likely increase the revenue requirement due to timing of termination payments to the counterparty. In addition, energy no longer supplied by DWR would need to be replaced by the IOUs in either the short-term market or under new long-term power contracts from other suppliers.

For a discussion of additional credit implications of DWR's power purchase contracts, see "SECURITY FOR THE BONDS – Priority Long-Term Power Contracts" and "RISK FACTORS – Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs."

Priority Long-Term Power Contracts

Priority Long Term Power Contracts are power purchase contracts that provide, in effect, that payments by DWR under the contracts are to be paid or are payable prior to bonds, notes, or other indebtedness of DWR secured by a pledge or assignment of the revenues of DWR under the Act and other amounts in the Electric Power Fund. Substantially all of DWR's power purchases, both in terms of energy and cost, will be made under the Priority Long-Term Power Contracts and for that reason substantially all of the operating expenses of the Power Supply Program will be incurred under the Priority

Long-Term Power Contracts. The long-term power contracts in effect as of February 15, 2008 are summarized in the table below.

Certain of DWR's contracts for the supply of natural gas have similar payment priority provisions, and are considered "Priority Long-Term Power Contracts," as described below under the caption "THE DWR POWER SUPPLY PROGRAM – Natural Gas Supply."

Description of DWR's Power Purchase Contracts

The following table sets forth the name of the counterparty under each of DWR's power purchase contracts, the product type, the origin of the power, whether it provides for fuel tolling, whether it is a Priority Long-Term Power Contract, the IOU to which it is allocated for operational and rate-setting purposes, and the projected annual amount of energy to be derived under such contract until it expires. The projected annual energy deliveries are estimates only and are based on production simulation analyses performed by or on behalf of DWR for purposes of planning future revenue requirements. The projected annual energy delivery estimates, particularly for dispatchable contracts, may vary significantly from actual future deliveries, depending on future events including, but not limited to, the amount and cost of IOU-contracted or -provided power available, and the bundled load requirement of each IOU, in a specific period.

Projected Annual Energy (MWh) From DWR Power Contracts [1]

Counterparty, Product Type [2] and Origin of Power [3]	Fuel Tolling [4]	Priority [5]	IOU Alloca-tion	2008	2009	2010	2011	2012	2013	2014	2015
Bear Energy BC; Must-take; Market	No	Yes	SDG&E	1,632,800	1,627,600	1,627,600	–	–	–	–	–
Bear Energy D; Dispatchable; Generator-specific; Gas-fired	Yes	Yes	SCE	525,421	373,528	316,046	–	–	–	–	–
Cabazon; As-Available; Generator-specific; Wind	No	Yes	SDG&E	114,093	113,885	113,885	113,885	114,093	113,885	–	–
Calpeak; Dispatchable; Generator-specific; Gas-fired	Yes	Yes	PG&E/ SDG&E	60,971	18,790	1,267	880	–	–	–	–
Calpine 1; Must-take; Market	No	Yes	PG&E	8,784,000	8,760,000	–	–	–	–	–	–
Calpine 2; Dispatchable; Generator-specific; Gas-fired	Yes	Yes	PG&E	852	–	450	720	1,328	–	–	–
Calpine 3; Dispatchable; Generator-specific; Gas-fired	Yes	Yes	PG&E	89	–	–	–	–	–	–	–
Colton; Dispatchable; Generator-specific; Gas-fired	Yes	Yes	SCE	160	160	–	–	–	–	–	–
Coral; Must-take; Market	Yes	Yes	PG&E	3,974,887	3,965,888	3,258,202	2,648,451	1,248,997	–	–	–
Goldman Sachs; Must-take; Market	No	Yes	SCE	7,027,200	7,008,000	7,008,000	7,008,000	–	–	–	–

Counterparty, Product Type [2] and Origin of Power [3]	Fuel Tolling [4]	Priority [5]	IOU Alloca-tion	2008	2009	2010	2011	2012	2013	2014	2015
GWF; Dispatchable; Generator-specific; Gas-fired	Yes	Yes	PG&E	–	–	–	153	–	–	–	–
High Desert; Dispatchable; Generator-specific; Gas-fired	Yes	Yes	SCE	3,299,765	3,127,009	2,864,627	169.424	–	–	–	–
KRCD; Dispatchable; Generator-specific; Gas-fired	Yes	No	PG&E	2,185	1,386	216	619	901	192	–	672
PPM Energy; Dispatchable; Market	Yes	Yes	PG&E	703,454	730,251	771,609	105,194	–	–	–	–
PG&E Energy Trading; As-Available; Generator-specific; Wind	No	Yes	SCE	176,711	176,390	176,390	147,276	–	–	–	–
Sempra; Must-take; Combination of Market and Generator-Specific	Yes	Yes	SCE	12,550,400	12,515,200	12,515,200	9,360,000	–	–	–	–
SF Peakers [6]; Dispatchable; Generator-specific; Gas-fired	Yes	No	PG&E	–	29,446	14,308	11,121	16,097	12,486	19,776	84,462
Sunrise; Dispatchable; Generator-specific; Gas-fired	Yes	Yes	SDG&E	3,399,514	3,425,112	3,363,408	3,461,063	1,752,435	–	–	–
Wellhead; Dispatchable; Generator-specific; Gas-fired	Yes	Yes	PG&E	1,795	–	93	389	–	–	–	–
Whitewater-wind; As-Available; Generator-specific; Wind	No	Yes	SDG&E	172,466	172,152	172,152	172,152	172,466	172,152	–	–
Total				42,426,764	42,044,796	32,203,454	23,199,328	3,306,316	298,715	19,776	85,134

1 Projections are from the 2008 Supplemental Revenue Requirement.

2 Product types are described as "must-take," "dispatchable" and "as available." "Must-take" refers to the contract requirement that all energy generation associated with the contract is required to be purchased by DWR. "Dispatchable" refers to the contractual right to purchase only that amount of energy that DWR – or the IOUs operating on behalf of DWR – requests, up to full generation under the available capacity of the contract. "As available" means DWR is required to purchase any energy generated from a specific project, as available.

3 Origin of power is described as "generator-specific" or "market." "Generator-specific" means the contract power is derived from a specific generator. For such contracts, the type of generation facility is also indicated. "Market" means the power is derived from market purchases.

4 "Fuel Tolling" means a contract provision tying the contract price to natural gas prices. Under a contract with such a provision, fuel is provided by DWR or by the seller.

5 "Priority" means the contract is a Priority Long-Term Power Contract. See "THE DWR POWER SUPPLY PROGRAM – Power Purchase Contracts – *Priority Long-Term Power Contracts*."

6 Construction of the facility has not yet started. Contract start date and termination date are unknown at this time.

Dispute with Power Supplier

In May 2002, DWR notified Sempra Energy Resources ("Sempra") in writing that Sempra had failed to perform its obligations under the long-term power contract (the "Agreement") between the parties, including the obligation to build new power plants to help meet the State's long-term energy needs. In Sempra Energy Resources v. Department of Water Resources, filed in May 2002 in San Diego County Superior Court (Case No. 789291), Sempra sought declaratory relief as to the respective rights and duties of plaintiff and DWR under the Agreement. In July 2002, DWR cross-complained, alleging that Sempra induced DWR to enter into the Agreement through intentional and negligent misrepresentations and, in the alternative, that Sempra had breached its obligation under the Agreement to construct the simple-cycle phase of the Elk Hills project and had anticipatorily breached its obligations under the Agreement to construct and deliver power to DWR from additional new power projects. DWR sought damages and either a declaration that the Agreement is not binding on DWR or that, if the Agreement is binding on DWR, a declaration that Sempra must perform its obligations and an injunction prohibiting Sempra from freely substituting market energy for energy from new sources of generating capacity. In 2003, Sempra was granted summary judgment, which was reversed by the court of appeal in 2005. The case is now before the court of appeal again on Sempra's appeal of the trial court's denial of its motion to compel arbitration of the dispute.

On a separate matter relating to the Agreement, DWR filed a demand for arbitration with the American Arbitration Association in February 2006, asserting that Sempra had breached the Agreement and the covenant of good faith and fair dealing by failing to schedule and deliver energy in a manner that prevents or alleviates potential or existing transmission curtailments, in particular by overscheduling its Mexicali project in the face of severe congestion. DWR seeks damages and termination of the Agreement. The arbitration panel ruled that DWR's claims should be heard by the Federal Energy Regulatory Commission (FERC), but stayed its ruling pending determination by FERC. FERC ruled that the claims should be heard by the arbitration panel. Sempra has moved for clarification and reconsideration at FERC. At DWR's request, the arbitration panel has scheduled a hearing for November 2008. A prior contract arbitration concluded in April 2006. In that arbitration, the panel awarded DWR approximately $70 million in relief but declined DWR's request that it terminate the Agreement.

During these disputes, DWR has continued to perform under the Agreement and the Agreement costs are included in DWR's revenue requirement.

Natural Gas Supply

General

A major component of the cost of procuring power is the cost of procuring and transporting natural gas, the fuel used to produce most of that power. During the 2008 revenue requirement period, natural gas costs are projected to account for approximately 40 percent of total contract costs. During that period, gas-fired generation is projected to account for approximately 58 percent of total contract generation and of that percentage approximately 67 percent is from must take contracts. "Tolling" provisions in some of DWR's power purchase contracts give DWR the right, but not the obligation, to provide all or part of the natural gas required to generate electricity pursuant to the contract. Where tolling is an option, DWR has elected to provide fuel on recommendation of the IOUs that manage the procurement of fuel for and dispatch of energy from specific contracts. See "THE DWR POWER SUPPLY PROGRAM – Power Purchase Contracts," above, for a listing of agreements that provide for fuel tolling.

With the assistance of its consultants, DWR forecasts its natural gas costs using production simulation analyses to project contract fuel requirement volumes and natural gas prices that are fixed either through physical hedges (i.e. fixed price gas contracts) or through financial hedges or, for those volumes not covered by such hedges, using a combination of near-term natural gas price future market quotes, computer modeling and certain discretionary adjustments (as described in "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – Substantive Considerations in Establishing Revenue Requirements – *Natural Gas Price and Cost Projections*") in determining its annual Retail Revenue Requirement. If DWR's actual natural gas costs are not within the forecast during the revenue requirement period, an adjustment to Power Charges could be required during the course of the revenue requirement period. DWR submitted Supplemental Revenue Requirement Determinations for 2003 and 2004 and a Revised Revenue Requirement Determination for 2005, 2006, 2007 and 2008 based, in part, on revised natural gas cost projections. Any necessary revisions, to date, in Power Charges resulting from Supplemental or Revised Revenue Requirements have been implemented by the CPUC within the time frame required by the Rate Agreement and have not, to date, resulted in a revenue shortfall that would cause the Operating Account to fall below the Minimum Operating Expense Available Balance. See "SECURITY FOR THE

BONDS – Operating Account." DWR with input from IOUs, which provide much of the operational oversight of fuel tolling, has hedged natural gas costs for a substantial portion of DWR's ongoing natural gas needs through 2011, see *Current Fuel Hedging* below. Such hedging is taken into consideration when formulating DWR's Retail Revenue Requirements. See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES." A portion of the gas supply, after physical or financial hedging, remains subject to future price variation. DWR estimates the reasonable potential range of that price variation and establishes its revenue requirements to maintain projected Operating Account and Operating Reserve Account balances to provide amounts sufficient to accommodate that range of potential price variance. If necessary to maintain the necessary or appropriate account balances, DWR would revise or supplement its revenue requirement and submit it to the CPUC for processing and for changes in Power Charges to the customers of the IOUs to reflect any associated changes in the DWR revenue requirement.

Principal Natural Gas Contracts

DWR's principal natural gas contract is the Williams Energy Trading Company fuel contract. The Williams contract provides 18 million MMBtu of natural gas via firm price deliveries each year for 2008 through 2010. It is a "Priority Long-Term Power Contract" and provides, in effect, that payments by DWR under the contract is to be paid or is payable prior to bonds, notes, or other indebtedness of DWR secured by a pledge or assignment of the revenues of DWR under the Act and other amounts in the Electric Power Fund.

Physical and Financial Management of Natural Gas

CPUC-approved operating agreements (in the case of PG&E and SDG&E) and a CPUC order (in the case of SCE) (collectively, the "Operating Arrangements") define the respective responsibilities of DWR and each IOU as they relate to the administration of the allocated DWR power purchase agreements, including but not limited to managing the tolling provisions of such agreements. In particular, the IOUs, as agent for DWR, (1) assume operational responsibilities for scheduling energy with CAISO based on economic considerations including natural gas prices, spot energy prices and heat rate efficiency of generating units associated with the tolling agreements, (2) manage daily physical gas purchases for delivery to tolling agreements including: scheduling, transporting, imbalance management, storing and selling gas, as the case may be, and (3) manage natural gas price risk and volatility by physically and financially hedging natural gas needs. DWR supports and monitors the IOUs as they manage and settle the physical fuel requirements and price risk hedging for any tolling agreements while remaining legally and financially responsible for the fuel obligations under each of DWR's power purchase contracts. To the extent the IOUs do not procure gas or fail to manage gas price risk by hedging, DWR retains the right and responsibility to assure that gas is supplied to meet the performance requirements of the contracts.

Current Fuel Hedging

Based on information from and in coordination with the IOUs, DWR hedges a portion of the price risk associated with projected gas purchases that will be made to operate DWR's power purchase contracts. The primary purpose of such hedging is to reduce the gas price volatility under conditions in which the natural gas price rises, perhaps significantly, above the baseline projected market gas price identified in a specific revenue requirement determination. For the 2008 revenue requirements period, DWR estimates that the IOUs have collectively secured, or have reasonably firm plans to secure, on behalf of DWR hedges for 99 million MMBtu at or near the baseline projected gas price identified in the revised 2008 revenue requirement determination using a mix of option and fixed price instruments. In addition, 18 million MMBtu are effectively hedged at a price of $4.21 per MMBtu through deliveries from a fuel procurement agreement with Williams. The majority of the remaining fuel price exposure is hedged with a mix of options at strike prices higher than the base case fuel price, which provides price certainty for approximately 90 percent of total projected fuel requirements in 2008.

Customer Base

DWR supplies power to bundled customers in the same service areas served by the three IOUs, comprising approximately 11 million residential, commercial and industrial accounts representing approximately three-quarters of all Californians.

PG&E is a wholly owned subsidiary of PG&E Corporation and is headquartered in San Francisco, California. PG&E is the largest investor-owned utility in the nation, providing natural gas and electric service to approximately 5.0 million accounts. Its service area covers approximately 70,000 square miles in northern and central California.

SCE is a wholly owned subsidiary of Edison International and is headquartered in Rosemead, California. SCE provides electric service to approximately 4.7 million accounts. Its service area is approximately 50,000 square miles in central and southern California.

SDG&E is a wholly owned subsidiary of Sempra Energy and is headquartered in San Diego, California. SDG&E provides natural gas and electric service to approximately 1.3 million accounts. Its service area covers approximately 4,100 square miles in southern California, including San Diego County and southern Orange County.

In 2007, DWR supplied approximately 57,000 gigawatt-hours of energy to customers in the IOU service areas and received approximately $4.288 billion in Power Charge Revenues and approximately $861 million in Bond Charge Revenues. The table below sets forth certain statistics relating to power supplied by DWR to and Bond Charges collected from the service areas of the IOUs in 2007.

	IOU Service Area			
Service Area Statistic (2007)	**PG&E**	**SCE**	**SDG&E**	**DWR Total**
DWR Power Supplied, Jan 2007 - Dec 2007 (% of IOU Load)	27%	26%	46%	28%
DWR Power Supplied, Max Month (% of IOU Load)	Oct – 07 (30%)	Dec- 07 (31%)	Aug – 07 (54%)	Dec – 07 (31%)
DWR Power Supplied, Max Month (GWh)	Aug – 07 (2,120)	Dec – 07 (2,038)	Aug – 07 (989)	Aug – 07 (5,063)
Bond Charges, January 2007 - December 2007 (In $ millions)	$384	$393	$84	$861
Bond Charges, January 2007 - December 2007 (as a Percentage)	45%	46%	10%	100%

Collection of Revenues

General

Because DWR does not have the personnel, equipment or customer information necessary to provide its own metering, billing and collection services, servicing arrangements obligating the IOUs to provide such services on behalf of DWR are necessary for the timely collection of Bond Charges and Power Charges. Under the Act, the CPUC is required, upon request of DWR, to order the IOUs to provide such services on terms and conditions that reasonably compensate the IOUs for such services. The CPUC has adopted orders and approved agreements with respect to each IOU providing for the terms and conditions upon which such services are to be provided (each such order or agreement, a "Servicing Arrangement"). On March 15, 2007, the CPUC adopted the currently effective servicing orders applicable to each IOU. These servicing orders amended and restated the then existing servicing orders adopted on December 19, 2002, which, in turn, amended and restated the servicing agreements that were applicable to SCE and SDG&E and the servicing order that was applicable to PG&E.

DWR has covenanted in the Indenture that it will maintain servicing arrangements in effect at all times while Bonds are outstanding. In addition, DWR has covenanted in the Indenture not to voluntarily consent to or permit any amendment of any servicing arrangement unless DWR determines that the amendment will not have a material adverse affect on the ability of DWR to comply with the provisions of the Indenture. See APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Servicing Arrangements; Collection of Revenues" and "RISK FACTORS – Collection of Bond Charges and Power Charges."

Summary of Servicing Arrangements

Each IOU is bound by its Servicing Arrangement to transmit (or provide for the transmission of) and distribute over the IOU's system power supplied by DWR in accordance with the Servicing Arrangement, the Act, other applicable laws, CPUC rules and regulations and agreements between the IOU and DWR. The Servicing Arrangements do not obligate the IOUs to construct high voltage transmission improvements.

Each of the IOUs is to provide metering services, meter reading services, billing services, and collection services for DWR, except to the extent that these services are performed by a third-party as authorized in the Servicing Arrangements. Each IOU is to follow its customary standards, policies and procedures in performing these services, which are regulated by the CPUC. DWR charges are included in the IOUs' regular billing statements. The IOUs will not permit customers to direct how partial payments of balances due on consolidated bills will be applied. Each IOU will generally allocate partial payments from customers proportionally between DWR and the IOU, all as more specifically set forth in the Servicing Arrangements. Each IOU will collect DWR's charges and its own charges from customers using its own collection practices and will carry out disconnection policies (all of which practices and policies are subject to CPUC regulation). See "THE DWR POWER SUPPLY PROGRAM – Collection of Revenues – *Collection Experience.*"

The IOUs remit amounts collected for Bond Charges and Power Charges to DWR on a daily basis accompanied by reports to support the remittances. Currently, SCE and SDG&E remit on an actual collection basis. PG&E continues to remit revenues to DWR for each day on an estimated basis, and reconciles the remittances and the actual billed amounts, all based on a 180-day collection curve. Since January 2003, the IOUs have made monthly remittances of surplus energy sales-related revenues, all as further provided in the Servicing Arrangements. For each of the IOUs, reconciliations may result in refunds to the IOUs of overpaid amounts or in additional remittances to DWR in the event of under-remittances.

Under the Servicing Arrangements, the IOUs are entitled to recover the reasonable costs of providing billing and related services. DWR pays each IOU for specified costs of these services, as provided in the Servicing Arrangements. All of the foregoing costs are included by DWR in its revenue requirement submissions to the CPUC and recovery is sought from customers through DWR charges. Delinquent payments by DWR bear interest at a variable interest rate equal to three percent plus the prime lending rate of a commercial bank named in each Servicing Arrangement.

Each Servicing Arrangement provides that all amounts required to be remitted to DWR by the IOU shall be held by the IOU in trust for DWR and shall be remitted to DWR, subject to periodic adjustment.

Each Servicing Arrangement permits DWR to assign or pledge its rights to receive payments from the IOU to the Trustees under the Indenture to secure DWR's obligations thereunder. DWR has assigned its rights to customer payments under each Servicing Arrangement under the Indenture. Under each Servicing Arrangement DWR's rights and obligations will be automatically transferred if the California Legislature creates an entity to assume the rights and obligations of DWR under the Act.

The stated termination date of each IOU's Servicing Arrangement is the later of (i) 180 days after the last date that DWR Charges are imposed on customers or (ii) 180 days after the last date that the IOU sells surplus energy on behalf of DWR.

Each Servicing Arrangement lists "Events of Default" by the IOU that include any failure to remit funds to DWR that continues unremedied for three business days and certain failures to observe or perform under the Servicing Arrangement. Upon any Event of Default by the IOU, DWR may, in addition to exercising its remedies under the Servicing Arrangement or under applicable law, apply to the CPUC for appropriate relief, including but not limited to the termination of the Servicing Arrangement, in whole or in part, and apply to the CPUC (and, if necessary, a court) for sequestration and payment to DWR or the Trustees of amounts due DWR under the Servicing Arrangement.

Each Servicing Arrangement also states that DWR will be in default under the Servicing Arrangement if DWR fails to perform any of a number of duties listed in the Servicing Arrangement, including the failure to pay certain moneys to the IOU. Upon any default by DWR, the IOU may not terminate the Servicing Arrangement in whole or in part or any obligation thereunder, but the IOU may exercise any other remedies available under the Servicing Arrangement, the Act, and other applicable laws, rules and regulations.

Each Servicing Arrangement includes a *force majeure* clause that provides that neither DWR nor the IOU is liable for any delay or failure in performance of any part of the Servicing Arrangement (including the obligation to remit money at the times therein specified) from any cause beyond its reasonable control, including but not limited to: unusually severe weather; flood; fire; lightning; epidemic; quarantine restriction; war; sabotage; act of a public enemy; earthquake; insurrection; riot; civil disturbance; strike; restraint by court order or government authority; or any combination of these causes, which by the exercise of due diligence and foresight DWR or the IOU could not reasonably have been expected to avoid and which by the exercise of due diligence is unable to overcome. Notwithstanding these provisions, each party's obligation to pay money under the Servicing Arrangement continues to the extent such party is able to make such payment and any amounts required to be remitted to DWR by the IOU shall be held by the IOU in trust for DWR and remitted to DWR as soon as reasonably practicable. Amounts paid to or by DWR pursuant to the *force majeure* clause shall not bear interest.

DWR has the right under each Servicing Arrangement to request an audit, conducted by DWR, of each IOU's records and procedures.

The Servicing Arrangements include remittance procedures related to Cost Responsibility Surcharge revenues from certain direct access, departing load and Community Choice Aggregation customers. For a discussion of direct access, departing load, Community Choice Aggregation and the Cost Responsibility Surcharge, see "THE DWR POWER SUPPLY PROGRAM – Direct Access, Departing Load and Community Choice Aggregation."

In anticipation of the CAISO implementation of a Market Redesign and Technology Upgrade ("MRTU"), DWR is in discussions with the IOUs to identify and amend the affected provisions of the currently effective Servicing Arrangements and Operating Arrangements. DWR expects these discussions to result in an interim letter agreement that sets forth remittance and operating procedures to become effective upon implementation of the MRTU. DWR expects that the IOUs will submit the interim letter agreement to CPUC for approval. At this time, DWR cannot predict the outcome of its discussions with the IOUs concerning the revised remittance and operating procedures ultimately to be imposed on the IOUs by the CPUC in response to the MRTU. For a discussion of the MRTU, see "THE DWR POWER SUPPLY PROGRAM – Power Supply Projection."

Additional Information

Other important provisions are contained in the Servicing Arrangements, which are available as described under "GENERAL INFORMATION." For a description of the IOUs, see "THE DWR POWER SUPPLY PROGRAM – Customer Base."

Collection Experience

According to filings made by the IOUs with FERC, over the last five years each of the IOUs had uncollectible amounts that averaged approximately 0.2% of its operating revenues. No IOU had uncollectible amounts that exceeded 0.5% of operating revenues in any one year. Accordingly, DWR does not consider nonpayment by customers to be a material risk to Bondholders. DWR considers such levels of uncollectible amounts in the calculation of DWR's revenue requirements. Under the Servicing Arrangements, risk of noncollection is to be borne proportionately by DWR and the IOUs.

Direct Access, Departing Load and Community Choice Aggregation

General

"Direct access" customers consist of retail electricity customers in the service areas of the IOUs who stopped purchasing electricity from the IOUs and obtain their electricity from alternative providers of electric service providers. "Departing load" consists of retail electricity customers who commence customer generation or whose load was projected to be served by the IOU, but who are now receiving electrical energy and, transmission and distribution services, from a publicly owned utility. "Community Choice Aggregation" refers to the ability of local governments within the service area of the IOUs to aggregate the power needs of their community and purchase electricity on their behalf from providers of electric service other than the IOUs pursuant to California Public Utilities Code Section 366.2. Recent regulatory developments, including the imposition of a Cost Responsibility Surcharge on certain direct access, departing load and future Community Choice Aggregation customers, have mitigated the risk that direct access, departing load and Community Choice

Aggregation will create revenue shortfalls and necessitate revised revenue requirement submissions by DWR, as described below.

Direct Access

The CPUC suspended the right of IOU customers to switch to direct access after September 20, 2001. Under existing law, such suspension will continue until DWR no longer supplies power under the Act. See "THE DWR POWER SUPPLY PROGRAM – Power Purchase Contracts" for a description of the various DWR power purchase contracts and their terms. The CPUC has also imposed a Cost Responsibility Surcharge on direct access customers intended to prevent cost shifting as a result of direct access migration prior to September 20, 2001. However, retail electricity customers who elected direct access service on or before the date DWR began its Power Supply Program and have not since returned to bundled service continue to be eligible for direct access service and do not pay the Cost Responsibility Surcharge. CPUC Decision 02-03-055 prohibits the IOUs from accepting any other new direct access service requests not already approved by the CPUC, including requests from existing qualified direct access end-users that wish to add new direct access locations or accounts to their service (subject to certain flexibility described in the next paragraph). For a description of the Cost Responsibility Surcharge, including the definition thereof, see "THE DWR POWER SUPPLY PROGRAM – Direct Access, Departing Load and Community Choice Aggregation - *Cost Responsibility Surcharge*," below.

The CPUC has granted existing direct access accounts a limited degree of flexibility with respect to the direct access suspension. On February 19, 2004, the CPUC issued Decision 04-02-024 which allows current direct access customers to increase load at one or more locations, provided that the net load of the same customer does not increase within a utility's service territory. This provision is intended to maintain the "standstill principle" adopted in Decision 02-03-055, while accounting for "normal changes in business operations." In Decision 04-07-025, the CPUC clarified rules governing load growth for existing direct access accounts. In addition, existing direct access customers may take bundled service from the applicable IOU for up to 45 days while switching between electric service providers.

While the option to elect direct access service is suspended until DWR no longer supplies power under the Act, the CPUC has initiated a proceeding to consider whether, when or how direct access should be restored. The CPUC recently 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 continues the proceeding to consider possible approaches to expediting DWR's exit from its role of supplying power under the Act. DWR currently expects the last of DWR's power purchase contracts to expire in 2015. See the table titled "Projected Annual Energy (MWh) From DWR Power Contracts under the caption "THE DWR POWER SUPPLY PROGRAM – Power Purchase Contracts – *Description of DWR's Power Contracts*.

Departing Load

Departing load includes "municipal departing load" and "customer generation." Municipal departing load refers to load that either relocates to, or resides on land that is annexed by, a publicly owned utility (e.g., municipal utilities or irrigation districts). Customer generation refers to the generation of electricity by a retail customer for its own use.

In 2008, DWR expects the total load from municipal departing load and customer generation to be in an amount equal to less than two percent[*] of total retail sales. Unlike direct access, the growth of municipal departing load and customer generation is not expressly limited by CPUC decision. However, to prevent cost shifting, the CPUC has imposed a Cost Responsibility Surcharge on certain classes of municipal departing load and customer generation customers similar to the Cost Responsibility Surcharge imposed on certain direct access customers. Pursuant to various CPUC orders, DWR shall receive a portion of its revenue requirement from that Cost Responsibility Surcharge. There is a risk that the IOUs will not be able to collect the Cost Responsibility Surcharge from all municipal departing load customers who are billed. Under the Servicing Arrangements, risk of non-collection is to be borne proportionately by DWR and the IOUs. See "THE DWR POWER SUPPLY PROGRAM – Collection of Revenues – *Collection Experience*." In its proceeding to establish the procedures for the IOUs to bill and collect the Cost Responsibility Surcharge from departing load customers, the CPUC has granted a limited exemption from the Cost Responsibility Surcharge to clean distributed generation. The exemption is available to clean distributed generation not exceeding one megawatt and was extended to include the first megawatt of clean distributed generation from facilities with up to five megawatts of capacity. Any amount of the Department's revenue requirements not paid through the Cost Responsibility Surcharge by exempt customer generation departing load is currently

[*] Based on information provided by IOUs to DWR during the 2008 Revenue Requirement process.

being paid by bundled service customers. See "THE DWR POWER SUPPLY PROGRAM – Direct Access, Departing Load and Community Choice Aggregation –*Cost Responsibility Surcharge*," below.

Community Choice Aggregation

Community Choice Aggregation, authorized by legislation enacted in 2002 ("AB 117"), refers to the ability of a city or county to aggregate all the electrical demand of the residents, businesses and municipal users under its jurisdiction and to meet this demand from an electricity provider other than an IOU, such as an independent electrical service provider. In the decision implementing AB 117, the CPUC has determined that future Community Choice Aggregation customers shall pay charges (including DWR charges) intended to prevent cost shifting to the bundled customers of the IOUs. For a description of the Cost Responsibility Surcharge, including the definition thereof, see "THE DWR POWER SUPPLY PROGRAM – Direct Access, Departing Load and Community Choice Aggregation - *Cost Responsibility Surcharge*," below.

Significant volumes of Community Choice Aggregation load could lead to changes in DWR rates to accommodate reduced IOU retail deliveries of DWR power. At present no load has left bundled utility service to form or become part of a Community Choice Aggregator pursuant to AB 117. However, the San Joaquin Valley Power Authority (SJVPA) filed an Implementation Plan with the CPUC in January 2007 to become a Community Choice Aggregator. That plan was certified by the CPUC in May 2007. At the present time, SJVPA is expected to serve approximately 2,000 GWh of load to eleven cities and one county. SJVPA's plans to phase in its Community Choice Aggregation program have been delayed and are not expected to result in power procurement for customers prior to November 2008. The SJVPA Community Choice Aggregation load, if implemented, will reduce bundled load in both PG&E and SCE's service territories.

Other communities have indicated a willingness to pursue Community Choice Aggregation, including the City and County of San Francisco, several cities located to the east of San Francisco Bay, the City of Chula Vista, Marin County, and the City of Fresno. The process for aggregators to initiate feasibility studies and ultimately procure power on behalf of load is estimated to be eighteen to twenty-four months. It is possible that Community Choice Aggregation could lead to substantial reductions in bundled sales volumes.

In the CPUC proceeding implementing AB 117 concerning Community Choice Aggregation, the CPUC established that the Cost Responsibility Surcharge would be paid by Community Choice Aggregation customers and that the method for calculating the Cost Responsibility Surcharge adopted for direct access and municipal departing load customers, as modified by CPUC Decision 06-07-030 would also apply to Community Choice Aggregation customers.

Pursuant to Assembly Bill 80 (Public Utilities Code Section 366.1) and CPUC Decision 05-01-009, the City of Cerritos ("Cerritos"), as owner of the Magnolia Power Project, was granted authority to act as a community aggregator within the service area of SCE. Consistent with an agreement between Cerritos and SCE, the Cost Responsibility Surcharge paid by Cerritos' customers to SCE is the Cost Responsibility Surcharge applicable to Community Choice Aggregation customers. The methodology for calculating Cerritos' Cost Responsibility Surcharge was subsequently revised in CPUC Decision 07-04-007 to reflect the revisions adopted in Decision 06-07-030. Between October 2007 and January 2008, the monthly Bond Charge billed to Cerritos ranged from $22,000 to $18,000.

Cost Responsibility Surcharge

In a series of decisions, the CPUC ordered certain classes of direct access, municipal and customer generation departing load, and Community Choice Aggregation customers to pay the Cost Responsibility Surcharge related to historical stranded costs and ongoing costs. Included in the Cost Responsibility Surcharge is a DWR Bond Charge component, which is assessed to pay debt service associated with DWR's bond issuances and a DWR Power Charge component, which pays a portion of the above-market costs of the DWR power portfolio. The Bond Charge and the Power Charge components are rates imposed on total electricity usage by these direct access, departing load and Community Choice Aggregation customers by the CPUC in concert with the establishment of Power Charges and Bond Charges on bundled customers. Cost Responsibility Surcharge revenues reduce the amount of Bond Charges and Power Charges that must be imposed on bundled customers to recover Bond Related Costs and Department Costs. In the aggregate, the payments by direct access load, departing load, and Community Choice Aggregation load and from bundled customer load for the DWR Bond Charge and the DWR Power Charge flow to DWR to recover the DWR Bond Related Costs and Department Costs. See "RISK FACTORS – Departing Load and Community Choice Aggregation."

Financing of the Power Supply Program

Prior Sources of Financing

The original sources of funding to initiate the Power Supply Program in 2001 included advances from the State's General Fund totaling approximately $6.1 billion (the "State Loan"), a loan from a consortium of commercial and investment banks totaling $4.3 billion (the "Bank Loan"), and revenues from electricity sales. In 2002, DWR issued the Series 2002 Bonds in the aggregate principal amount of $11.263 billion to repay the State Loan and the Bank Loan, establish certain debt service reserves and operating reserves, pay costs of obtaining credit enhancement and pay costs of issuance. In 2005, DWR issued the Series 2005 Bonds in the aggregate principal amount of $2.594 billion to refund $2.353 billion of outstanding Series 2002 Bonds and effectively reduce its aggregate debt service payments by approximately $278 million through 2022. In March 2008, DWR issued the Series 2008H Bonds to refund certain Series 2002 Bonds and Series 2005 Bonds bearing interest at variable rates. On April 2, 2008, DWR, issued the Series 2008I Bonds to refund certain Series 2002 Bonds. On April 17, 2008, DWR issued the Series 2008J Bonds to refund certain Series 2005 Bonds. The Bonds issued in 2002, 2005 and 2008, as of May 1, 2008, are described in the following table.

Power Supply Program Debt Portfolio

Series	Initial Principal Amount	Outstanding Principal Amount[4]	Current Interest Rate Mode
Series 2002A	$ 6,313,500,000 [1]	$ 2,825,290,000	Fixed Rate
Series 2002B	1,000,000,000	1,000,000,000	Daily Rate
Series 2002C	2,750,000,000 [2]	2,333,000,000	Weekly Rate
Series 2002D	500,000,000 [2]	-	N/A
Series 2002E (Taxable)	700,000,000	-	N/A
Total Project Issuance	$11,263,500,000		
Series 2005F	$ 759,400,000	$ 759,400,000	Daily Rate
Series 2005G[3]	1,834,600,000 [2]	1,136,300,000	Weekly Rate
Series 2008H	1,006,510,000	1,006,510,000	Fixed Rate
Series 2008I	150,000,000	150,000,000	Daily Rate
Series 2008J-1	130,000,000	130,000,000	Daily Rate
Series 2008J-2	200,000,000	200,000,000	Weekly Rate
Total Refunding Issuance	$ 3,750,510,000		
Total Bonds Outstanding		$9,540,500,000	

[1] $2,352,210,000 of the Series 2002A Bonds were refunded with proceeds of the Series 2005 Bonds.

[2] $250,000,000 of the Series 2002C Bonds, $300,000,000 of the Series 2005G Bonds and all of the Series 2002D Bonds were refunded with proceeds of the Series 2008H Bonds. An additional $150,000,000 of the Series 2002C Bonds were refunded with proceeds of the Series 2008I Bonds. An additional $330,000,000 of the Series 2005G Bonds were refunded with proceeds of the Series 2008J Bonds.

[3] Includes Bonds to be refunded by the Series 2008K Bonds.

[4] Excludes $470,140,000 of Bonds (consisting of $448,740,000 of Series 2002A Bonds and $21,400,000 of Series 2005G Bonds) which are scheduled to be paid on May 1, 2008.

Interest Rate Hedges

DWR has entered into floating-to-fixed interest rate swap agreements with several different counterparties in an aggregate initial notional amount of $4,023,900,000 to reduce the risk of interest rate volatility with respect to its variable rate Bonds. As of May 1, 2008 the aggregate outstanding notional amount is $3,938,600,000. These swaps include nine floating to fixed interest rate swap transactions in an aggregate initial notional amount of $1,429,900,000 executed in connection with the issuance of the Series 2002 Bonds, and six floating to fixed interest rate swap transactions in an aggregate initial notional amount of $2,594,000,000 executed in connection with the issuance of the Series 2005 Bonds to refund a portion of the Series 2002A Bonds, identified above. In 2006, DWR entered into five "basis swaps" designed to

mitigate the risk that the rate received by DWR on the variable leg of the related original swaps may not equal the variable rate on the related Bonds. The basis swaps have notional amounts equal from time to time to the outstanding notional amounts of the related original swaps, and, in effect, change the variable rate received by DWR on $1,006,400,000 notional amount of such original swaps.

Under the Indenture, required payments under Qualified Swaps are Bond Related Costs and are paid from the Bond Charge Payment Account on parity with debt service on the Bonds. In order for an interest rate swap agreement to qualify as a Qualified Swap, the Indenture generally requires, among other things, that (i) the swap provider have ratings not lower than the third highest rating category from each rating agency then maintaining a rating for the provider, and in no event lower than the rating category designated by any such rating agency for the Bonds subject to the interest rate swap, or (ii) the interest rate swap will not result in a reduction or withdrawal of any ratings on the Bonds subject to the swap. See "SECURITY FOR THE BONDS" and the definitions of "Qualified Swap" and "Qualified Swap Provider" in APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE." All of DWR's interest rate swap agreements are Qualified Swaps. The providers of DWR's outstanding swaps have current long-term ratings of at least A1 by Moody's, A+ by S&P and A+ by Fitch Inc.. Under DWR's interest rate risk management policy currently in effect, as a general approach, DWR will limit long term hedging contracts to counterparties rated double-A or better, and in no case will enter into contracts with counterparties rated lower than single-A.

Payments owed by DWR to each swap provider and payments owed by such swap provider to DWR are netted against each other within each interest rate swap transaction, but generally not among transactions. Any net swap receipts are deposited in the Bond Charge Collection Account. Any net swap payments by DWR are Bond Related Costs, payable from the Bond Charge Payment Account. See "SECURITY FOR THE BONDS – Accounts and Flow of Funds under the Indenture."

DWR's interest rate swap agreements generally provide that upon early termination, the mark-to-market value of the interest rate swap transaction is payable from one party to the other. The Indenture provides that the total amount of any termination payment by DWR under a swap agreement shall not be required to be paid by DWR faster than on a level amortization basis with quarterly payments over a period ending no sooner than three years following the date of termination, with the first installment commencing no earlier than six months after the date of termination; *provided*, *however*, that if the Department elects to terminate any swap at its option, any termination payment shall be made as provided in the swap agreement. DWR does not currently intend to terminate any swap agreements in connection with the issuance of the Series 2008 Bonds. For a further discussion of DWR's interest rate swap portfolio and its contingent mark-to-market liability, see Note 5 of the audited financial statements in Appendix A hereof.

The tables below set forth the Series of Bonds hedged, the outstanding notional amount of the interest rate swap, the fixed or variable interest rate to be paid by DWR, the variable rates to be received by DWR, the expiration date and the name of the counterparty.

2002 and 2005 Interest Rate Swaps

Hedged Bond Series	Outstanding Notional Amount (as of May 1, 2008)	Fixed Rate Paid by DWR (% per annum)	Variable Rate Received by DWR	Expiration Date (May 1)	Counterparty
2002B/C	$ 93,600,000	2.914	67% LIBOR	2011	Bayerische Landesbank
2002B/C	233,700,000 [1]	3.024	67% LIBOR	2012	Bayerische Landesbank
2002B/C	189,694,000	3.405	100% BMA	2013	JPMorgan Chase Bank
2002B/C	94,847,000	3.405	100% BMA	2013	Morgan Stanley Capital Services
2002B/C	28,359,000	3.405	100% BMA	2013	Merrill Lynch Capital Services, Inc.
2002B/C	194,400,000 [1]	3.204	67% LIBOR	2014	Bank of America N.A.
2002B/C	174,200,000 [1]	3.280	67% LIBOR	2015	Bayerische Landesbank
2002B/C	202,300,000 [1]	3.342	67% LIBOR	2016	BNP Paribas
2002B/C	201,800,000 [1]	3.389	67% LIBOR	2017	Morgan Stanley Capital Services
2005F/G	286,800,000 [2]	3.184	66.5% LIBOR	2015	Depfa Bank
2005F/G	485,300,000	3.228	66.5% LIBOR	2016	BNP Paribas
2005F/G	480,000,000 [3]	3.282	66.5% LIBOR	2017	Wachovia Bank
2005F/G	514,200,000 [4, 5]	3.331	66.5% LIBOR	2018	Deutsche Bank
2005F/G	306,200,000	3.256	64% LIBOR	2020	Deutsche Bank
2005F/G	453,200,000	3.325	64% LIBOR	2022	Royal Bank of Canada
Total	$3,938,600,000				

[1] Effective July 1, 2006, DWR entered into basis swaps to mitigate basis risk associated with the variable rates received on swaps for these associated outstanding notional amounts.

[2] On the date of issuance of the Series 2008J Bonds, $25.5 million of the outstanding notional amount was allocated to Series 2008J-1, and $193 million of the outstanding notional amount was allocated to Series 2008J-2.

[3] On April 1, 2008, $267.3 million of the outstanding notional amount was allocated to the Series 2002B Bonds and Series 2002C Bonds.

[4] On the date of issuance of the Series 2008J Bonds, $104.5 million of the outstanding notional amount was allocated to Series 2008J-1, and $7 million of the outstanding notional amount was allocated to Series 2008J-2. On the date of issuance of the Series 2008K Bonds, $295,000,000 of the outstanding notional amount will be allocated to the Series 2002B Bonds and the Series 2002C Bonds.

[5] On April 1, 2008, $32.7 million of the outstanding notional amount was allocated to the Series 2002B Bonds and the Series 2002C Bonds.

2006 Basis Swaps

Hedged Bond Series	Outstanding Notional Amount	Variable Rate Paid by DWR	Variable Rate Received by DWR	Expiration Date (May 1)	Counterparty
2002B/C	$ 233,700,000	67% LIBOR	62.83% 5Yr CMS	2012	BNP Paribas
2002B/C	194,400,000	67% LIBOR	62.70% 5Yr CMS	2014	Deutsche Bank
2002B/C	174,200,000	67% LIBOR	62.60% 5Yr CMS	2015	JPMorgan Chase Bank
2002B/C	202,300,000	67% LIBOR	62.80% 5Yr CMS	2016	BNP Paribas
2002B/C	201,800,000	67% LIBOR	62.66% 5Yr CMS	2017	JPMorgan Chase Bank
Total	$1,006,400,000				

Investments

Funds on deposit in the Electric Power Fund are currently invested in a combination of cash and cash equivalents, unsecured investment agreements and a forward purchase agreement collateralized with U.S. Treasury securities. The following table details the Electric Power Fund investments by account, as of March 31, 2008.

Electric Power Fund Investments as of March 31, 2008

Investment	Administration, Operating and Priority Contract Accounts	Operating Reserve Account	Bond Charge Collection and Bond Charge Payment Accounts	Debt Service Reserve Account	Totals
Cash and Cash Equivalents [1]	$1,293,180,102	$547,940,710	$999,910,495	$467,280,783	$3,308,312,089
Investment Agreements [2]	–	–	–	350,000,000	350,000,000
Fwd. Purchase Agreement [3]	–	–	–	100,000,000	100,000,000
Totals	$1,293,180,102	$547,940,710	$999,910,495	$917,280,783	$3,758,312,089

[1] Cash and Cash Equivalents includes approximately $3.277 billion in SMIF (described below), approximately $17.3 million held by a fiscal agent and $14.3 million held in the State Treasury.
[2] Investment agreement providers include AIG SunAmerica Life Insurance Company, FSA Capital Management Services LLC and Royal Bank of Canada, New York Branch.
[3] The forward purchase agreement provider is Merrill Lynch Capital Services, Inc.

Of the approximately $3.758 billion in the Electric Power Fund as of March 31, 2008, approximately $3.277 billion or 87% was invested in the Surplus Money Investment Fund ("SMIF"). SMIF is comprised of moneys on deposit in the State's Centralized Treasury System for investment by the State Treasurer in the Pooled Money Investment Account (the "PMIA"). As of March 31, 2008, the PMIA held approximately $41.3 billion of State moneys and $23.7 billion of moneys invested for about 2,648 local governmental entities through the Local Agency Investment Fund (the "LAIF"). The assets of the PMIA as of March 31, 2008 are shown in the following table:

Analysis of the Pooled Money Investment Account Portfolio

(as of March 31, 2008)

Type of Security	Amount (in millions)	Percent of Total [1]
U.S. Treasury Bills and Notes	$3,153	4.9%
Commercial Paper	4,201	6.5
Certificates of Deposit	12,551	19.3
Corporate Bonds	285	0.4
Federal Agency Securities	22,050	34.0
Bankers' Acceptances	-	0.0
Bank Notes	1,100	1.7
Loans per Government Code	12,167	18.7
Time Deposits	9,448	14.5
Repurchase Agreements	-	0.0
Reversed Repurchases	-	0.0
Total	$64,952	100.0%

[1] May not add due to rounding.
Source: State of California, Office of the State Treasurer.

The State's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the Pooled Money Investment Board (consisting of the State Treasurer, the State Controller and the Director of Finance). The PMIA does not now invest, nor has if ever invested, in Structured Investment Vehicles or Collateralized Debt Obligations. The PMIA's holdings are displayed quarterly on the State Treasurer's website and may be accessed under PMIB Quarterly Reports. The PMIA is not invested in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverses are cash matched. The average life of the investment portfolio of the PMIA as of March 31, 2008 was 205 days.

Annual Debt Service on the Bonds

The following table sets forth the annual debt service requirements on the Bonds, including the Series 2008K Bonds.

Annual Bond Debt Service

Year Ending December 31	2002A and 2008H (fixed rate)	2002B/C, 2005F/G and 2008I/J (variable rate)[1]	2008K	Totals[2]
2008[3]	$ 105,119,172	$ 109,467,580	$ 6,584,983	$ 221,171,735
2009	556,770,729	321,963,202	13,702,750	892,436,681
2010	607,739,515	272,001,278	13,702,750	893,443,543
2011	454,235,823	427,785,484	13,702,750	895,724,057
2012	448,546,273	437,264,200	13,702,750	899,513,222
2013	659,267,385	228,160,315	13,702,750	901,130,450
2014	498,577,531	390,535,175	13,702,750	902,815,456
2015	416,219,185	476,143,428	13,702,750	906,065,363
2016	63,441,869	832,297,394	13,702,750	909,442,013
2017	330,037,025	558,158,991	13,702,750	901,898,766
2018	108,429,825	498,212,276	286,101,375	892,743,476
2019	35,843,175	881,437,607	--	917,280,782
2020	35,843,175	880,996,605	--	916,839,780
2021	320,178,338	584,774,144	--	904,952,481
2022	445,256,703	457,086,925	--	902,343,628
Totals[2]	$5,085,505,721	$7,356,284,604	$416,011,108	$12,857,801,434

[1] Excludes debt service on the Refunded Bonds. Interest on hedged Bonds calculated at the fixed interest rates on the applicable interest rate swap agreements. Interest on unhedged variable rate Bonds calculated at 4.695% per annum.

[2] Totals may not add up due to rounding.

[3] Excludes the amount of debt service on the Bonds paid in 2008 prior to the issuance of the Series 2008K Bonds.

Summary of Operating Results

The following table provides a summary of historical and projected revenues, expenditures and fund balances of the Power Supply Program for the calendar years 2006 through 2009 (in millions).

	Historical ($)		Projected ($)	
Power Charge Accounts	**2006**	**2007**	**2008**	**2009**
Balance in Power Charge Accounts at January 1				
Operating, Priority Contract and Administrative Accounts	$ 866	$ 995	$1,224	$ 878
Operating Reserve Account	555	591	612	548
Total Beginning Balance in Power Charge Accounts*	1,420	1,586	1,836	1,426
Power Charge Accounts Operating Revenues				
Power Charge Revenues	4,348	4,287	3,162	3,009
Surplus Power and Gas Sales Revenues	495	448	60	42
Energy Litigation Settlements	206	40	-	-
Interest Earnings	64	88	86	66
Total Power Charge Accounts Operating Revenues	5,113	4,863	3,308	3,117
Power Charge Accounts Operating Expenses				
Power Costs	4,926	4,585	3,690	3,610
Administrative and General	22	29	28	27
Total Power Charge Accounts Operating Expenses *	4,948	4,613	3,718	3,636
Net Revenues - Power Charge Accounts	165	250	(410)	(519)
Balance in Power Charge Accounts at December 31*	$1,586	$1,836	$1,426	$ 906
Bond Charge Accounts	**2006**	**2007**	**2008**	**2009**
Balance in Bond Charge Accounts at January 1				
Bond Charge Collection Account	$ 168	$ 214	$ 273	$ 186
Bond Charge Payment Account	579	581	560	620
Debt Service Reserve Account	910	910	930	937
Total Beginning Balance in Bond Charge Accounts*	1,657	1,705	1,764	1,743
Bond Charge Accounts Revenues				
Bond Charge Revenues	864	861	831	831
Interest Earnings	74	85	83	83
Total Bond Charge Account Revenues	938	946	914	914
Bond Charge Accounts Expenses				
Debt Service on Bonds	890	888	935	936
Total Bond Charge Account Expenses	890	888	935	936
Net Revenues - Bond Charge Accounts	48	59	(21)	(23)
Balance in Bond Charge Accounts at December 31*	$1,705	$1,764	$1,743	$1,721

* Totals may not add due to rounding.

Source: Results for calendar years 2006 and 2007 are derived from DWR's operational reports. Projected results for calendar year 2008 and 2009 are consistent with the assumptions in DWR's Supplemental 2008 Determination of Revenue Requirements for the period January 1, 2008-December 31, 2008, which is available at DWR's website at http://www.cers.water.ca.gov and was submitted to the CPUC on February 15, 2008 for allocation. The projections should be evaluated based on those assumptions. All figures are in millions of dollars. Numbers may not add, due to rounding. All projections are the responsibility of DWR. PricewaterhouseCoopers LLP (PwC), independent auditors for DWR, has neither examined nor compiled such projections and, accordingly, PwC does not express an opinion or any other form of assurance with respect thereto. The PwC report included in Appendix A relates to historical financial information of the Department of Water Resources Electric Power Fund. The PwC report does not extend to the projections set forth above and should not be read to do so. These projections were not prepared with a view toward compliance with the guidelines established by the American Institute of Certified Public Accountants for preparation and presentation of prospective financial information.

CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES

General

The primary revenues used for the payment of the Bonds and Bond Related Costs are Bond Charge Revenues, which constitute part of the Trust Estate securing the Bonds. The Rate Agreement requires the CPUC to impose Bond Charges sufficient to ensure that amounts on deposit in the Bond Charge Payment Account are adequate to pay all Bond Related Costs as they come due. Bond Related Costs include Bond debt service, Qualified Swap payments, credit enhancement and liquidity facilities charges, and costs relating to other financial instruments and servicing arrangements related to the Bonds. Bond Charges are required to be imposed on all electric power sold to each bundled customer, whether that power is provided by DWR or by the IOUs.

The Rate Agreement also requires the CPUC to impose Power Charges on customers who buy power from DWR (generally, the customers who buy power from the IOUs) for the purpose of paying "Department Costs," including the costs that DWR incurs to procure and deliver power. The Rate Agreement requires the CPUC to impose Power Charges that are sufficient to provide moneys in the amounts and at the times necessary to satisfy the Retail Revenue Requirements as described below.

Additionally, in a series of decisions, the CPUC ordered certain classes of direct access, municipal and customer generation departing load, and Community Choice Aggregation customers to pay the Cost Responsibility Surcharge related to historical stranded costs and ongoing costs. Included in the Cost Responsibility Surcharge is a DWR Bond Charge component, which is assessed to pay debt service associated with DWR's bond issuances, and a DWR Power Charge component, which pays a portion of the above-market costs related to the DWR power portfolio. The Bond Charge and the Power Charge components are rates imposed on total electricity usage by these direct access, departing load and Community Choice Aggregation customers by the CPUC in concert with the establishment of Power Charges and Bond Charges on bundled customers. Cost Responsibility Surcharge revenues reduce the amount of Bond Charges and Power Charges that must be imposed on bundled customers to recover Bond Related Costs and Department Costs. In aggregate, the payments by direct access load, departing load, and Community Choice Aggregation load and from bundled customer load for the DWR Bond Charge and the DWR Power Charge flow to DWR to recover the DWR Bond Related Costs and Department Costs. See "RISK FACTORS – Departing Load and Community Choice Aggregation."

In 2007, DWR supplied approximately 57,000 gigawatt-hours of energy to customers in the IOU service areas and received approximately $4.288 billion in Power Charge Revenues and approximately $861 million in Bond Charge Revenues.

Rate Agreement

The CPUC and DWR have entered into the Rate Agreement pursuant to the Act to facilitate the issuance of Bonds and for the benefit of Bondholders and all other persons to whom DWR is obligated to pay Bond Related Costs (other than the providers of servicing and administrative services to DWR after the termination of DWR's long-term power contracts). The obligation of the CPUC to calculate, revise and impose Bond Charges is irrevocable and cannot be amended. Other provisions of the Rate Agreement may be amended only by an amendment approved by DWR and the CPUC. Under the Indenture, DWR has covenanted not to amend the Rate Agreement unless DWR has determined that the amendment will not have a material adverse effect on the ability of DWR to comply with the provisions of the Indenture.

In the Rate Agreement, the CPUC has covenanted and agreed to calculate, revise and impose from time to time, Bond Charges sufficient to provide moneys so that the amounts available for deposit in the Bond Charge Payment Account from time to time, together with amounts on deposit in the Bond Charge Payment Account, are at all times sufficient to pay or provide for the payment of all Bond Related Costs when due in accordance with the "Financing Documents" (defined in the Rate Agreement attached as Appendix D). The Rate Agreement provides that this covenant shall have the force and effect of a "financing order" under the California Public Utilities Code and shall be irrevocable and enforceable in accordance with its terms, including, without limitation, in circumstances in which DWR has breached its obligations under the Rate Agreement or in respect of the Financing Documents. Under the California Public Utilities Code, a "financing order" is binding upon the CPUC as it may be constituted from time to time, and the CPUC has no authority to rescind, alter or amend its obligations thereunder. Under the Act, the rights, powers and duties of the CPUC may not be diminished or impaired in a manner that would adversely affect the interests or rights of Bondholders. See, however, "RISK FACTORS –

Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs – *Application and Enforcement of CPUC's Bond Charge Rate Covenant*."

In the Rate Agreement, the CPUC has also covenanted and agreed to calculate, revise and impose, from time to time, Power Charges sufficient to provide moneys in the amounts and at the times necessary to satisfy DWR's "Retail Revenue Requirements" (defined in the Rate Agreement attached as Appendix D) as specified by DWR.

In the event of a failure of the CPUC to calculate and impose Bond Charges in accordance with the Rate Agreement, the Rate Agreement is enforceable against the CPUC by the Co-Trustee under the Indenture 30 days after DWR has defaulted under its obligations contained in the Financing Documents (as defined in the Rate Agreement) and failed to enforce the Rate Agreement. The Rate Agreement imposes certain conditions to the exercise by the Co-Trustee of DWR's rights under the Rate Agreement.

The Rate Agreement specifies the actions to be taken by DWR and the timetable that the CPUC will use to calculate, revise and impose Bond Charges and Power Charges. See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – CPUC Actions to Calculate, Revise and Impose Bond Charges and Power Charges."

To enable the CPUC to set and adjust Bond Charges and Power Charges, the Rate Agreement requires DWR to periodically determine and submit cost information and projections to the CPUC and to provide reports to the CPUC concerning fund balances under the Indenture. See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – DWR Actions to Establish Revenue Requirements." The Rate Agreement specifies information that DWR will include with its Retail Revenue Requirements.

Subject to certain conditions in the Rate Agreement, if DWR projects that within the next 120 days there will be insufficient amounts on deposit in the Bond Charge Payment Account to make timely payment of Bond Related Costs, the Rate Agreement requires DWR to submit to the CPUC a request that the CPUC increase Bond Charges, and the CPUC is required to calculate and impose revised Bond Charges to pay such Bond Related Costs no later than 120 days from the date following DWR's request. The Rate Agreement further provides that, even if DWR does not submit such a request, the CPUC is bound by its covenant to calculate, revise and impose Bond Charges, as described above.

A decision approving the Rate Agreement was adopted by the CPUC on February 21, 2002, and the Rate Agreement was executed by the CPUC and DWR as of March 8, 2002. The decision approving the Rate Agreement is final and unappealable under California law. A copy of the Rate Agreement is attached as Appendix D to this Official Statement.

Under the Indenture, DWR may not issue Bonds unless DWR and the CPUC have entered into a rate agreement with respect to such Bonds. The Series 2008K Bonds and all other Bonds currently Outstanding are entitled to the benefits of the Rate Agreement attached as Appendix D.

Counsel to the CPUC and Bond Counsel will each deliver an opinion, in connection with the issuance of the Series 2008K Bonds, concerning the Rate Agreement, among other matters. See APPENDIX F – "PROPOSED FORM OF OPINION OF BOND COUNSEL," for a copy of the form of proposed opinion of Bond Counsel. Such opinions represent expressions of professional judgment and not guarantees of result.

Substantive Considerations in Establishing Revenue Requirements

DWR's revenue requirements generally consist of Bond Related Costs and Department Costs, which are to be satisfied primarily by Bond Charge Revenues and Power Charge Revenues, respectively.

Bond Related Costs and Bond Charge Revenues

Bond Related Costs include (a) debt service on the Bonds, (b) payments required to be made: (i) under agreements with issuers of credit and liquidity facilities, including letters of credit, bond insurance, guarantees, debt service reserve fund surety bonds, lines of credit, reimbursement agreements, and standby bond purchase agreements, (ii) under agreements relating to other financial instruments entered into in connection with the Bonds, including but not limited to investment agreements, hedges, interest rate swaps, caps, options and forward purchase agreements, and (iii) under agreements relating to the remarketing of Bonds, including but not limited to remarketing agreements, dealer agreements and auction agent agreements, (c) deposits to the Debt Service Reserve Account, and (d) other costs as specified in the Rate Agreement,

attached as Appendix D. Bond Charge Revenues include (y) revenues from Bond Charges (including a Bond Charge component of Cost Responsibility Surcharge revenues from certain direct access, departing load and Community Choice Aggregation customers, as described in "THE DWR POWER SUPPLY PROGRAM – Direct Access, Departing Load and Community Choice Aggregation") and (z) interest earned on Bond Charge Account balances.

Department Costs and Power Charge Revenues

Department Costs generally include (1) costs associated with power supply (including natural gas supply) to be delivered under DWR's power contracts, including Priority Long-Term Power Contracts; (2) gas collateral and/or hedging costs; (3) administrative and general expenses; and (4) amounts required to maintain necessary Power Charge Account balances, including any amounts required to maintain operating reserves as determined by DWR (see "SECURITY FOR THE BONDS – Operating Account" and "– Operating Reserve Account"). Revenues to be used to pay Department Costs include all Revenues other than Bond Charge Revenues and payments to DWR under Qualified Swaps relating to Bonds. Such Revenues to be used to pay Department Costs include (a) Revenues from Power Charges (including Power Charge Revenues and Cost Responsibility Surcharge revenues from certain direct access and departing load customers, as described in "THE DWR POWER SUPPLY PROGRAM – Direct Access, Departing Load and Community Choice Aggregation"); (b) revenues from other power sales; and (c) investment earnings on Power Charge Accounts.

DWR Projections

In order to project Bond Related Costs for the applicable revenue requirement period, DWR determines the aggregate amount of scheduled Bond principal and interest on fixed-rate Bonds becoming due during such period (generally the calendar year), makes assumptions regarding variable interest rates (subject to certain minimum assumptions required by the Indenture) and other Bond Related Costs and determines the amounts required to be available to be transferred to the Bond Charge Payment Account at the times required by, and otherwise in accordance with, the Indenture. See APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE."

In order to project Bond Charge Revenues, Department Costs, Power Charge Revenues and other Revenues, and in order to assist the CPUC and the IOUs in determining the appropriate charges to produce such revenues, DWR makes projections regarding IOU retail customer load, direct access, departing load, power supply, surplus energy sales, natural gas prices, administrative and general expenses and other factors affecting DWR's revenues and expenses.

The following is a description of certain of the principal considerations taken into account by DWR in determining its revenue requirements. While the considerations described below are generally representative of DWR's current practices in calculating its revenue requirements, this description does not purport to be exhaustive. DWR currently engages consultants to assist in the development and monitoring of DWR's revenue requirements.

Bond Charge Collection Account and Bond Charge Payment Account

Under the Indenture, DWR is required to include in its revenue requirements amounts estimated to be sufficient to cause the amount on deposit in the Bond Charge Collection Account, on the first Business Day of each month, to be at least equal to the amounts projected to be required to be paid out of the Bond Charge Payment Account that month. All Bond Charge Revenues are to be deposited in the Bond Charge Collection Account. Subject to the prior claim on revenues in the Bond Charge Collection Account for the payment of Priority Contract Costs, on or before the last Business Day of each month, DWR is required to transfer from the Bond Charge Collection Account to the Bond Charge Payment Account such amount as is necessary to make the amount in the Bond Charge Payment Account sufficient to pay all Bond Related Costs estimated to accrue or be due and payable during the next succeeding three calendar months. Interest accruing on unhedged Variable Rate Bonds during any future period is required by the Indenture to be, and currently is, assumed to accrue at a rate equal to the greater of (a) 130 percent of the highest average interest rate on such Variable Rate Bonds in any calendar month during the twelve (12) calendar months ending with the month preceding the date of calculation, or such shorter period that such Variable Rate Bonds shall have been outstanding, or (b) 4.0 percent.

Debt Service Reserve Account

In determining its revenue requirements, DWR includes any amounts necessary to maintain in the Debt Service Reserve Account an amount equal to the "Debt Service Reserve Requirement." The Debt Service Reserve Requirement is an amount equal to maximum aggregate annual debt service on all outstanding Bonds, determined in accordance with the

Indenture. For purposes of calculating the amount of the Debt Service Reserve Requirement from time to time, interest accruing on unhedged Variable Rate Bonds during any future period is assumed to accrue at a rate equal to the greater of (a) 130 percent of the highest average interest rate on such Variable Rate Bonds in any calendar month during the twelve (12) calendar months ending with the month preceding the date of calculation, or such shorter period that such Variable Rate Bonds shall have been outstanding, or (b) 4.0 percent.

Retail Load Projections

DWR "shapes" the annual load forecasts provided by each IOU by using hourly load factor estimates that were developed by DWR in conjunction with, and reviewed by, each IOU to account for hourly variations in retail customer demand. These hourly estimates are needed in order for DWR to match hourly loads with DWR and IOU resource availability in the production simulation analyses that are performed to estimate DWR contract dispatch and cost in determining revenue requirements, as described in more detail below.

Direct Access and Departing Load Projections

DWR generally bases its estimates of direct access and departing load within each IOU's service territory on the applicable IOU's data and forecasts.

Power Supply Projections

The hourly load profile described above is utilized in DWR's electric market simulation to derive hourly energy dispatches required to serve retail customer load, including dispatches of power from DWR's power contracts. DWR projects hourly energy dispatches from its power supply contracts, IOU generation, other IOU resources and other generation resources required to serve IOU customer load. Estimates of IOU-supplied resources are generally based on IOU forecasts of utility owned generation, qualifying facility contract generation, and bilateral contract generation. DWR regularly updates its projections concerning qualifying facility contract terms and expiration dates, outage schedules, and net dependable resource capacity, among others, to reflect current details related to each IOU's resource portfolio. To project IOU hydroelectric resources, normal hydrologic conditions are generally projected for both California and the Pacific Northwest where meaningful hydrologic forecasts are not available.

Estimates of the amount of energy from DWR's power supply contracts to be delivered to IOU retail customers and the amount available to surplus energy buyers are determined using a market simulation model which produces a projection of contract-specific, hourly energy dispatches to meet the projected energy requirements of each IOU's retail customers. The terms and conditions incorporated in DWR's market simulation include, among other details, must-take energy volumes and dispatchable contract capacities, contract heat rates and unit outage rates as well as scheduling limitations. In order to be consistent with CPUC orders governing administration, operation and dispatch of DWR's contracts by the IOUs, energy dispatches from DWR's dispatchable long-term power contracts are assumed to be based on the objective of achieving the lowest possible total cost of power to IOU customers. In general, each incremental generating unit is dispatched only if the incremental cost of generating an additional MWh from that unit is less than projected market clearing prices for replacement power for that hour. Natural gas costs represent a significant component of DWR's total power supply costs under certain contracts and are discussed below. In anticipation of the CAISO implementation of MRTU early in 2008, DWR implemented a nodal market simulation model that mirrors the Locational Marginal Pricing provisions of MRTU. With the CAISO's delayed implementation of MRTU until later in the year, zonal pricing will still be in effect for the majority of 2008. DWR's nodal pricing market simulation model may produce results that differ from results that would be seen in a zonal pricing market simulation, but these differences should not be material. A listing of all of DWR's power supply contracts and certain of their characteristics, including whether DWR bears the risk of market changes in natural gas prices, appears under "THE DWR POWER SUPPLY PROGRAM – Power Purchase Contracts."

Surplus Energy Sales Projections

As with any retail providers of energy, due to contract obligations and daily and monthly variations in the IOUs' retail customer loads, DWR and the IOUs together, from time to time, purchase more energy than is needed to serve their retail customers. In 2002, the CPUC issued a decision allocating each of the thirty-two DWR power supply contracts to a specific IOU, and determining (with DWR's consent) that income from the sale of DWR and IOU excess energy would be shared on a pro-rata basis between DWR and the IOUs. This excess energy is sold in wholesale markets by the IOUs under the current Operating Arrangements governing administration, operation and dispatch of DWR's contracts. Historically, on

average, the price obtained for surplus power sales has been less than the price paid for power. However, these losses are an expected incident of appropriate portfolio management. The income from such sales of DWR power is used to partially offset DWR's Retail Revenue Requirement.

Natural Gas Price and Cost Projections

Power costs under many of DWR's power supply contracts is dependent on the price of natural gas. DWR utilizes a combination of near-term forward gas price indices and a natural gas forecast prepared by Navigant Consulting Inc. ("NCI"). The forecast for the 2008 Supplemental Revenue Requirement was prepared based upon the GPCM natural gas forecast model and yields long term monthly gas prices assumptions underlying the gas forecast. The forecast includes all significant supply and demand factors affecting the North American natural gas market such as the timing of major gas pipeline capacity changes, resource base additions and subtractions, gas demand, the price of crude oil, the timing and magnitude of certain liquefied natural gas capacities, imports and exports.

NCI compares the initial model results with the NYMEX forward price at Henry Hub and may adjust the forecasted prices so that they are generally in line with short-term market conditions as reflected on the NYMEX. DWR gas price modeling is performed twice annually or more often as required to reflect revised market conditions and assumptions.

In estimating natural gas costs for its revenue requirements and the potential variability in such costs during any given revenue requirement period, DWR also takes into account then existing or expected hedging of the price risk associated with projected gas purchases. The IOUs (as the entities with operational responsibility for DWR's power supply contracts) have the responsibility to arrange hedges on behalf of DWR. DWR has entered into both financial hedges and physical hedges for the 2008 revenue requirement period. Financial hedges include a mix of options and fixed-price instruments. Physical hedges consist of fixed price gas purchase contracts. These hedges do not impact the gas price forecast provided by NCI, but they do impact the estimation of total DWR contract fuel costs since costs for the volumes associated with the hedges are estimated by applying the effective hedged price to the corresponding hedged volumes. The cost of unhedged fuel requirements is estimated by applying the NCI gas price forecast to the corresponding unhedged volumes.

Administrative Cost Projections

DWR's general and administrative cost projections include estimates for consulting services for development and monitoring of the revenue requirements, litigation support, and financial advisory services.

Certain of DWR's general and administrative costs are subject to State budget appropriations, although they are paid by DWR and are part of the Retail Revenue Requirements. These costs include labor and benefits, professional services costs and pro rata charges for services provided to the Power Supply Program by other State agencies. Costs subject to budget appropriations are subject to the State budget process, which can involve delays.

Extraordinary Considerations

DWR takes into account settlement amounts and other benefits under settlement agreements with various litigants either only when received or when placed into escrow with only ministerial conditions to be met prior to receipt by DWR. See "LITIGATION AND ADMINISTRATIVE PROCEEDINGS."

Operating Account Balances

The Indenture requires DWR to include in its revenue requirements amounts estimated to be sufficient to cause the amount on deposit in the Operating Account at all times during any calendar month to equal the Minimum Operating Expense Available Balance. The Minimum Operating Expense Available Balance is determined by DWR at the time of each revenue requirement determination and is to be an amount equal to the largest projected difference between DWR's projected operating expenses and DWR's projected Power Charge revenues during any one month period during the revenue requirement period, taking into account a range of possible future outcomes. The Indenture covenant concerns the minimum amount required to be projected to be on deposit, and leaves to DWR the determination as to what total reserves are appropriate or required in the fulfillment of its duties under the Act. DWR has taken into account not only the Indenture-required minimums, but also potential natural gas price volatility and escalation, year-over-year revenue requirement volatility, and other factors. Each year, actual and projected year-end Power Charge Account balances, including the impact of net operating results, are taken into account in the establishment of revenue requirements for the subsequent year.

DWR Actions to Establish Revenue Requirements

Overview of the Rate Agreement

To enable the CPUC to set Bond Charges and Power Charges, the Rate Agreement requires DWR to periodically determine and submit to the CPUC the amount of DWR's Retail Revenue Requirements and information concerning Bond Related Costs. The Rate Agreement defines "Retail Revenue Requirements" as the amount of Department Costs that are to be recovered from Power Charges imposed by the CPUC from time to time. "Department Costs" means all amounts that DWR is entitled under the Act to recover (other than Bond Related Costs recovered from Bond Charges).

The Rate Agreement requires DWR, at least annually, and more frequently as deemed reasonably necessary or appropriate by DWR or the CPUC, to review, determine and revise its Retail Revenue Requirements and promptly to notify the CPUC following any determination or revision of DWR's Retail Revenue Requirements. The Rate Agreement also requires DWR to revise and communicate to the CPUC its Retail Revenue Requirements within 20 days of DWR projecting that within 120 days: (i) there will be insufficient funds in the Priority Contract Account to pay Priority Contract Costs; or (ii) there will be less than the Operating Reserve Account Requirement in the Operating Reserve Account; or (iii) shortfalls in the Priority Contract Account, Operating Account and the Operating Reserve Account will require moneys in the Bond Charge Collection Account to be used to pay Priority Contract Costs; or (iv) moneys in the Debt Service Reserve Account will be used to pay Bond Related Costs. DWR is also required by the Rate Agreement to revise and communicate to the CPUC within three business days its Retail Revenue Requirements in the event of a withdrawal from the Bond Charge Collection Account to pay Department Costs or in the event of a withdrawal from the Operating Reserve Account or the Debt Service Reserve Account such that the amount in either such account is less than the amount required by the Indenture or any other financing document.

The Rate Agreement also requires DWR to provide monthly reports to the CPUC concerning DWR's receipts and costs in a form that permits comparison to Retail Revenue Requirement projections. The Rate Agreement permits the CPUC to increase Power Charges to prevent any shortfall on an interim basis if it determines that existing Power Charges are not sufficient to pay Department Costs (which for this purpose includes funding or replenishment of the Bond Charge Collection Account, Bond Charge Payment Account or Debt Service Reserve Account at the levels and at the times required by the Indenture or other financing documents) even if DWR does not provide a revised Retail Revenue Requirement to the CPUC in a timely manner. The CPUC may also require DWR to submit revised Retail Revenue Requirements. If DWR has complied with its obligations under the Rate Agreement, the CPUC is required to impose revised Bond Charges and Power Charges, as appropriate and necessary, no later than 120 days following the filing with the CPUC of DWR's request that the CPUC take such action.

DWR has covenanted in the Rate Agreement that, upon the request of the CPUC, DWR will participate in any CPUC proceedings, including providing witnesses, attending public hearings and providing any other materials necessary to facilitate the CPUC's completion of its proceedings in connection with the establishment of Power Charges or Bond Charges by the CPUC.

Just and Reasonable Requirement

DWR has agreed in the Rate Agreement that prior to including any cost in the Retail Revenue Requirements communicated to the CPUC, DWR will conduct whatever procedures are required by law to determine that such cost is "just and reasonable" within the meaning of Section 451 of the California Public Utilities Code. In a lawsuit filed by PG&E in 2001, protesting certain aspects of DWR's determination of its 2002 revenue requirements, a California Court of Appeal decided that while DWR is required by the Act to determine that its costs are just and reasonable, it is not required to treat each revenue requirement as a regulation under the California Administrative Procedures Act, or otherwise follow any specific Administrative Procedures Act process in determining its revenue requirements. Neither party appealed that decision.

In June 2002, DWR adopted regulations establishing a procedure for public participation in the determination of its revenue requirements and establishing a standard for determining that costs included in its revenue requirements are just and reasonable. See Division 23, Chapter 4, Sections 510-517 of the California Code of Regulations (the "Revenue Requirement Regulations"). The Revenue Requirement Regulations require DWR to provide to interested parties an opportunity to submit comments on each proposed determination made by DWR. Under the Revenue Requirement Regulations, the time for comment by interested parties on a proposed revenue requirement determination and the bases therefor will normally be at

least 21 calendar days, but may be shorter in circumstances in which a shorter period is deemed reasonably necessary by DWR, including those circumstances in which the Rate Agreement requires revised revenue requirements to be communicated to the CPUC within a shorter period. If DWR adds significant additional material as the basis for its determination of its revenue requirements, the regulations require DWR to allow a reasonable period of time for public comment on the additional material.

The Revenue Requirement Regulations state that to protect ratepayer interests, the record of the determination must demonstrate by substantial evidence that the revenue requirement is just and reasonable, considering the circumstances existing or projected to exist at the respective times of DWR's decisions concerning whether to incur the costs comprising such revenue requirement, and the factors which under the Act are relevant to such determination and such decisions, including but not limited to the following express provisions of the Act:

- The development and operation of the Power Supply Program as provided in the Act is in all respects for the welfare and the benefit of the people of the State, to protect the public peace, health, and safety, and constitutes an essential governmental purpose;

- DWR must do those things necessary and authorized under the Act to make power available directly or indirectly to electric consumers in California (provided that except as otherwise stated, nothing in the Act authorizes DWR to take ownership of the transmission, generation, or distribution assets of any electrical corporation in the State of California);

- Upon those terms, limitations, and conditions as it prescribes, DWR may contract with any person, local publicly owned electric utility, or other entity for the purchase of power on such terms and for such periods as DWR determines and at such prices DWR deems appropriate taking into account all of the factors listed in section 80100 of the Act;

- DWR may sell any power acquired by DWR pursuant to the Act to retail end use customers, and to local publicly owned electric utilities, at not more that DWR's acquisition costs, including transmission, scheduling, and other related costs, plus other costs as provided in section 80200 of the Act;

- DWR must, at least annually, and more frequently as required, establish and revise revenue requirements sufficient, together with any moneys on deposit in the Electric Power Fund, to provide for all of the costs listed in section 80134(a) of the Act (including but not limited to the amounts necessary to pay debt service on bonds (including the Bonds), the amounts necessary to pay for power purchased by DWR, reserves in such amount as may be determined by DWR to be necessary or desirable and DWR's administrative costs); and

- Obligations of DWR authorized by the Act shall be payable solely from the Electric Power Fund.

In a lawsuit filed by PG&E in 2002, protesting DWR's determination of its 2003 revenue requirements, the Superior Court determined that although DWR was not required by statute to adopt regulations concerning the revenue requirement process, having adopted such regulations, DWR is required to follow them. In that case, the court decided that DWR had not allowed adequate time for review and comment on significant additional material added by DWR to the record of the proceedings. Neither party appealed that decision. DWR reopened its revenue requirement proceedings in order to allow additional time for review and comment by interested parties.

Actions taken by DWR under the Revenue Requirement Regulations are subject to judicial review in State court. Any such court proceedings could delay consideration of DWR's revenue requirements or result in a judicial determination that less than all of DWR's costs are just and reasonable. See "RISK FACTORS – Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs."

Proceedings under Revenue Requirement Regulations

DWR has followed the procedures set forth in the Revenue Requirements Regulations with respect to each of its revenue requirement determinations since the redetermination of its 2003 revenue requirements as described above, and has determined that each such revenue requirement was just and reasonable. The 2008 revenue requirement determination is available on DWR's website or upon request to DWR.

DWR determined that its 2008 revenue requirements are just and reasonable because they comport with DWR's statutory responsibilities, accurately reflect lawfully incurred costs, do not over-collect, and contain costs that are reasonable given the circumstances under which they were incurred. DWR believes, for those and other reasons, that DWR would prevail in legal proceedings, if any, that may be brought to force a judicial review of DWR's determination. DWR also believes that with the availability of the substantial reserves described under "SECURITY FOR THE BONDS," the pendency of any such proceedings will not disrupt the cash flow for the Power Supply Program to an extent that would prevent DWR from paying scheduled debt service on the Bonds. However, if such proceedings resulted in the recovery by DWR of less than all of DWR's actual costs, the ability of DWR to pay debt service on the Bonds could be adversely affected. See "RISK FACTORS – Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs."

Consultant to DWR

Navigant Consulting, Inc. ("NCI") provides consulting services to DWR to assist it in operating the Power Supply Program. These services include, but are not limited to, evaluation of the net short electric requirements provided to DWR by the IOUs, support in the evaluation and negotiation of power supply contracts, compilation and periodic updating of power supply quantities and costs from contracted power supply sources, estimation of fuel supply costs and requirements for contracted power supplies, estimation of future power purchase costs in the short-term market, evaluation of electric transmission constraints and associated impact on power supply deliveries, review of actions by other power suppliers and state governmental agencies for effect on the availability and cost of power supplies to meet the customers' net short electric requirements, support in the development of future DWR revenue requirements, revisions to current revenue requirement determinations and support to DWR in filings with the CPUC on revenue recovery and related issues. It is anticipated that NCI will continue to provide services to DWR related to the Power Supply Program subsequent to the issuance of the Series 2008K Bonds. In addition, NCI provided the Consultant's Report for the Series 2002 Bonds. This Official Statement does not include or constitute an update to the Consultant's Report provided for the Series 2002 Bonds.

CPUC Actions to Calculate, Revise and Impose Bond Charges and Power Charges

The CPUC has authority under the Rate Agreement to set charges to recover DWR's costs. The CPUC also has the authority to establish the procedures that it will use to set electric charges, and to allocate charges among service areas and electric customers.

Applications for rehearing of any CPUC order can be sought by interested parties. Under California law, applications for rehearing of any CPUC order or decision construing, applying, or implementing the provisions of the Act that (1) relates to the determination or implementation of DWR's revenue requirements, or the establishment or implementation of Bond Charges or Power Charges, or (2) in the sole determination of DWR, the expedited review of the CPUC order or decision is necessary or desirable for the maintenance of any credit ratings on any Bonds or for DWR to meet its obligations with respect to the Bonds, must be filed within 10 days after the date of mailing of the order or decision. The CPUC is required to issue its decision and order on rehearing within 20 days after the filing of the application for rehearing.

A court challenge to a CPUC decision on rehearing subject to the expedited procedures described in the preceding paragraph is made by filing a petition for writ of review with the California Supreme Court. The petition for writ of review is time-barred unless it is filed within 30 days after the CPUC mails an order denying rehearing, or, if the CPUC grants rehearing, within 30 days after the CPUC mails its decision on rehearing. The challenge is limited to issues specifically raised in an application for rehearing. The Court may either summarily deny the petition for writ of review or it may grant the petition, in which case there is oral argument and the Court issues a written opinion. California law provides that judicial review can only result in a prospective effect on rates and charges, including Bond Charges.

The California Public Utilities Code provides that orders of the CPUC that have become final and unappealable are conclusive in all collateral actions or proceedings. The California Public Utilities Code prohibits California courts from seeking to review or change a final and unappealable CPUC order. The CPUC order authorizing the Rate Agreement and the CPUC orders adopted on December 19, 2002 comprising the currently effective operating orders and the CPUC orders adopted on March 15, 2007 related to the currently effective Servicing Arrangements are final and unappealable.

Recent Revenue Requirements

2005 Revenue Requirements

In September 2004, DWR published its Proposed Determination of Revenue Requirements for 2005 to start its administrative process under its Revenue Requirement Regulations. After reviewing comments, DWR revised and made its determination in November 2004 and submitted it to the CPUC for implementation. The November 2004 Determination of $4.824 billion for both Power Charges and Bond Charges was found by DWR to be just and reasonable based on the administrative record. New information became available that changed DWR's projections of its revenue requirements for 2005. The new information included updated actual Electric Power Fund operating results through December 31, 2004; settlement agreements with El Paso Energy and Williams Energy Marketing & Trading; and natural gas price forecasts and related assumptions. As a result, DWR submitted a Revised 2005 Determination with the CPUC, reflecting a reduction of $166 million to its 2005 revenue requirements. In April 2005, the CPUC allocated the Revised 2005 Determination among the IOU service areas, consistent with the allocation methodology adopted by the CPUC in December 2004. In June, 2005 the CPUC adopted a permanent methodology to allocate the DWR revenue requirement among the IOU service areas. This methodology covers the DWR revenue requirement from 2004 onward.

A summary of the projected revenue requirements and the actual results from operations is shown in the table below.

For 2005 DWR projected total power costs were $4,522 million. Actual costs were $4,910 million. This increase was primarily due to actual fuel prices that exceeded those projected in the 2005 revenue requirements. The upward pressure in the natural gas markets was exacerbated by natural disasters in the U.S. Gulf Coast.

The aforementioned increased costs in 2005 were offset with revenues that exceeded projections by $464 million. The primary factors contributing to increased revenues were higher than projected surplus sales revenues, settlement receipts and CAISO revenues associated with system reliability from one contract counterparty.

The bond results closely tracked projections.

Category	Unit	Projected	Actual	Variance	Percentage
Power Revenues	$millions	$4,081	$4,545	$464	11%
Power Costs	$millions	$4,522	$4,910	$388	9%
Contract Dispatch	GWh	56,634	55,476	(1,158)	-2%
Bond Revenues	$millions	$897	$876	$(21)	-2%
Bond Costs	$millions	$922	$917	$(5)	-1%

2006 Revenue Requirements

In June 2005, DWR began the process for determining its 2006 revenue requirements consistent with the requirements of Sections 80110 and 80134 of the California Water Code and the Regulations, and provided information consistent with the requirements of the Rate Agreement.

In August 2005, DWR issued its Determination of Revenue Requirements for the period of January 1, 2006 through December 31, 2006 and notified the CPUC of DWR's Revenue Requirements consistent with the Rate Agreement. The August Determination was found to be just and reasonable based on an assessment of all comments, the administrative record, the Act, the Regulations, Bond Indenture requirements and the Rate Agreement.

Following its August Determination, DWR reviewed certain matters relating to that Determination, including, but not limited to, operating results of the Electric Power Fund (the "Fund") through September 30, 2005, an updated assumption regarding the interest rate used to calculate interest earnings on account balances, a Bond refunding that was completed on December 1, 2005, the Williams Energy Marketing & Trading Settlement Agreement, and developments in natural gas markets.

DWR's review of the aforementioned considerations resulted in several modifications, resulting in a Revised 2006 Determination which increased the total revenue requirements by $375 million relative to the August Determination. The Revised 2006 Determination was found to be just and reasonable based on an assessment of all comments, the administrative record, the Act, the Regulations, Bond Indenture requirements and the Rate Agreement.

On December 1, 2005, the CPUC adopted Decision 05-12-010, implementing an allocation of DWR's 2006 Revised Determination consistent with the permanent allocation methodology adopted in Decision 05-06-060.

A comparison of the revenue requirement projections and actual operations is shown in the table below. Revenues received by Power Charge Accounts exceeded projections by six percent primarily due to decreased Power Charge Revenues from retail customers that were more than offset by: increased surplus sales, settlement receipts and CAISO revenues associated with system reliability from one contract counterparty. Revenues to Bond Charge Accounts exceeded projections by six percent primarily due to higher than projected interest earnings and bond charge receipts from direct access customers.

Category	Unit	Projected	Actual	Variance	Percentage
Power Revenues	$millions	$4,825	$5,113	$288	6%
Power Costs	$millions	$4,924	$4,948	$24	0%
Contract Dispatch	GWh	55,693	54,834	(859)	-2%
Bond Revenues	$millions	$882	$938	$56	6%
Bond Costs	$millions	$898	$890	$(8)	-1%

2007 Revenue Requirements

On June 2006, DWR began the process for determining its 2007 revenue requirements consistent with the requirements of Sections 80110 and 80134 of the California Water Code and the Regulations, and provided information consistent with the requirements of the Rate Agreement.

In August 2006, DWR issued its Determination of Revenue Requirements for the period of January 1, 2006 through December 31, 2006 and notified the CPUC of DWR's Revenue Requirements consistent with the Rate Agreement. The August Determination was found to be just and reasonable based on an assessment of all comments, the administrative record, the Act, the Regulations, Bond Indenture requirements and the Rate Agreement.

Following its August Determination, DWR reviewed certain matters relating to that Determination, including, but not limited to, operating results of the Fund through September 30, 2006, an updated natural gas price forecast and updated assumptions regarding interest earnings on account balances and debt service on variable rate debt.

These revisions resulted in several modifications resulting in a Revised 2007 Determination which decreased the total revenue requirements by $128 million relative to the August Determination. This decrease was comprised of two components: a $115 million decrease in DWR's Power Charge Revenue Requirements; and a $13 million decrease in DWR's Bond Charge Revenue Requirements.

The Revised 2007 Determination was found to be just and reasonable based on an assessment of all comments, the administrative record, the Act, the Regulations, Bond Indenture requirements and the Rate Agreement.

On December 14, 2006, the CPUC issued Decision 06-12-035: "Order Allocating the 2007 Revenue Requirement Determination of the California Department of Water Resources" implementing an allocation of DWR's 2007 Revised Determination consistent with the permanent allocation methodology adopted in Decision 05-06-060.

A comparison of the revenue requirement projections and actual operations is shown in the table below. Revenues to Power Charge Accounts were nine percent higher than projections primarily due to higher than projected Power Charge Revenues from retail customers and surplus sales revenues. Revenues to Bond Charge Accounts exceeded projections primarily due to higher than projected interest earnings and bond charge receipts from direct access customers.

Category	Unit	Projected	Actual	Variance	Percentage
Power Revenues	$millions	$4,461	$4,863	$402	9%
Power Costs	$millions	$4,566	$4,613	$47	1%
Contract Dispatch	GWh	53,606	56,916	3,310	6%
Bond Revenues	$millions	$897	$946	$49	6%
Bond Costs	$millions	$920	$888	$(32)	-3%

2008 Revenue Requirements

In April 2007, DWR began the process for determining its 2008 revenue requirements consistent with the requirements of Sections 80110 and 80134 of the California Water Code and the Regulations, and provided information consistent with the requirements of the Rate Agreement.

DWR projected that the CAISO would implement its Market Redesign and Technology Upgrade during 2008 and sought information from the IOUs regarding the physical location and operating characteristics of their generating facilities which served as key input for DWR's analytical and forecasting efforts related to the 2008 Determination.

In August 2007, DWR issued its Determination of Revenue Requirements for the period of January 1, 2008 through December 31, 2008 and notified the CPUC of DWR's Revenue Requirements consistent with the Rate Agreement. The August Determination was found to be just and reasonable based on an assessment of all comments, the administrative record, the Act, the Regulations, Bond Indenture requirements and the Rate Agreement.

Following its August Determination, DWR reviewed certain matters relating to that Determination, including, but not limited to, operating results of the Fund through September 30, 2007 and an updated natural gas price forecast.

These revisions resulted in a Revised 2008 Determination which decreased total revenue requirements by $237 million relative to the 2008 August Determination. This decrease was comprised of two components: a $238 million decrease in DWR's Power Charge Revenue Requirements; and a $1 million increase in DWR's Bond Charge Revenue Requirements.

The Revised 2008 Determination was found to be just and reasonable based on an assessment of all comments, the administrative record, the Act, the Regulations, Bond Indenture requirements and the Rate Agreement.

On December 21, 2007, the CPUC issued Decision 07-12-030, "Opinion Allocating the Revised 2008 Revenue Requirement of the California Department of Water Resources" implementing an allocation of DWR's 2008 Revised Determination consistent with the permanent allocation methodology adopted in Decision 05-06-060.

Subsequent to the Revised 2008 Determination, DWR reviewed certain matters including, but not limited to, an amended and restructured Calpine 2 Power Supply Contract. This review resulted in a total decrease in cost of $630 million compared to the Revised 2008 Determination. The 630 million decrease results from the net effect of a decrease in contract costs due to the restructured Calpine 2 contract and from a related $93 million reduction in the year-end Power Charge Account balances.

DWR's Bond Charge Revenue Requirement remains unchanged.

The Supplemental 2008 Determination was found to be just and reasonable based on an assessment of all comments, the administrative record, the Act, the Regulations, Bond Indenture requirements and the Rate Agreement. DWR provided the Supplemental 2008 Revenue Requirements to the CPUC for allocation to customers in the IOU service areas on February 15, 2008. The CPUC issued its decision allocating DWR's 2008 Supplemental Revenue Requirements to the service territories of the IOUs on April 29, 2008.

On April 10, 2008, the CPUC approved a decision granting PG&E's request to allocate to PG&E's service territory all of the reduction in DWR's energy costs attributable to the restructuring of the Calpine 2 Power Supply Contract. That decision, however, denied PG&E's request to open a proceeding to consider further revisions to the permanent allocation methodology adopted in Decision 05-06-060.

LITIGATION AND ADMINISTRATIVE PROCEEDINGS

No litigation is pending or threatened against DWR, nor is DWR a party in any administrative proceeding pending before any administrative body, nor is any administrative proceeding pending before DWR, which (i) seeks to restrain or enjoin the sale or delivery of the Series 2008K Bonds or the performance by DWR of the purchase contract for the Series 2008K Bonds, (ii) challenges the constitutionality, validity or enforceability of the Indenture, the pledge of the Trust Estate, the Rate Agreement or any other document or approval necessary to the issuance of the Series 2008K Bonds, (iii) challenges the existence, organization or powers of DWR to adopt, execute and deliver the Indenture or the Rate Agreement or perform DWR's obligations under the Indenture or under the Rate Agreement, or (iv) challenges the constitutionality or validity of the Act or the powers of DWR thereunder.

Certain pending legal and administrative proceedings involving DWR or affecting DWR's Power Supply Program are summarized below. See also "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES" and "RISK FACTORS – Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs."

"Block Forward Contracts" Consolidated Actions

In February 2001, during the state of emergency described under "THE DWR POWER SUPPLY PROGRAM," Governor Davis, pursuant to the California Emergency Services Act, issued executive orders "commandeering" certain power purchase arrangements, referred to as "block forward contracts," held by PG&E and SCE in the California Power Exchange's (the "PX") CalPX Trading Services market. DWR took delivery of and paid a total of $350 million for energy under the contracts. The PX and 31 market participants claimed over $1 billion from the State as a result of the Governor's actions, in actions which were coordinated before the Sacramento County Superior Court in the Inverse Condemnation Cases, Judicial Council Coordination Proceeding No. 4203. Subsequently, the PX and all but one market participant dismissed their complaints. The remaining market participant was the Los Angeles Department of Water and Power ("LADWP"), which sought $63 million from the State. In February 2008, the Superior Court granted the State's motion for summary judgment against LADWP.

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, FERC initiated an administrative proceeding to calculate refunds for inflated prices in the CAISO and PX markets during 2000 and 2001. FERC ruled that DWR would not be entitled in that proceeding to approximately $3.5 billion in refunds associated with DWR's approximately $5 billion of short term purchases because DWR made those purchases bilaterally, not in the PX or CAISO markets. The Ninth Circuit Court of Appeals affirmed FERC, but left open the possibility of refunds on DWR's bilateral purchases in other FERC proceedings. In contrast, FERC ruled that DWR is entitled to refunds on purchases made by the CAISO where DWR actually paid the bill.

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

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

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

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

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

RISK FACTORS

This section of the Official Statement describes certain risk factors that may affect the payment of and security for the Bonds. Potential investors should consider, among other matters, these risk factors in connection with any purchase of the Series 2008K Bonds. The following discussion is not meant to present an exhaustive list of the risks associated with the purchase of any Series 2008K Bonds (and other considerations that may be relevant to particular investors) and does not necessarily reflect the relative importance of the various risks. Potential investors are advised to consider the following factors, along with all other information contained or incorporated by reference in this Official Statement, in evaluating whether to purchase the Series 2008K Bonds.

Certain Risks Associated With DWR's Power Supply Program

DWR's purchases and sales of electricity will likely end under the Power Supply Program before the Bonds are retired. See "THE DWR POWER SUPPLY PROGRAM – Power Purchase Contracts." Bond Charges are to be the primary source of money to pay debt service on the Bonds, and must be imposed by the CPUC whether or not DWR continues to purchase or sell electricity under the Power Supply Program. See "SECURITY FOR THE BONDS – Rate Covenants." Certain risks associated with the Power Supply Program are discussed in the following paragraphs.

Failure of Assumptions in Calculating Revenue Requirements

As explained above under "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – Substantive Considerations in Establishing Revenue Requirements" DWR makes a number of assumptions in determining its revenue requirements from time to time. A failure of any such assumptions could result in the insufficiency of Bond Charges to pay Bond Related Costs when due or the insufficiency of Power Charges to pay Department Costs, including Priority Contract Costs, when due. In particular, the failure of assumptions regarding natural gas costs (and a resulting failure of assumptions regarding power purchase costs, which are in part dependent on natural gas costs), coupled with a failure to adjust Power Charges quickly enough, could lead to such a cash flow insufficiency. In the event of such an insufficiency and the depletion of the Operating Account and the Operating Reserve Account, the payment of debt service on the Bonds when due may be dependent on the ability of DWR to obtain increases in Bond Charges or Power Charges, the adequacy of minimum balances in the Bond Charge Collection Account, the Bond Charge Payment Account and the Debt Service Reserve Account, or both. For a discussion of minimum balances in funds and accounts, see "SECURITY FOR THE BONDS." For a discussion of the process to obtain revised Bond Charges and Power Charges, see "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES."

Priority Long-Term Power Contracts

As explained below under "Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs," the use of amounts in the Bond Charge Collection Account (including Bond Charge Revenues) for the payment of debt service on the Bonds and other Bond Related Costs when due is subject to the possible prior use of such amounts to pay amounts due under DWR's Priority Long-Term Power Contracts (including any termination payments which may be payable by DWR). So long as DWR continues to bear financial responsibility for the Priority Long-Term Contracts, the Power Supply Program remains subject to this risk. If amounts in

the Bond Charge Collection Account are used to pay Priority Contract Costs, the payment of debt service on the Bonds when due may be dependent on the ability of DWR to obtain increases in Bond Charges or Power Charges, the adequacy of minimum balances in the Bond Charge Collection Account, Bond Charge Payment Account and the Debt Service Reserve Account, or both. To date, no amounts on deposit in the Bond Charge Collection Account have been needed or used to pay Priority Contract Costs. For a discussion of minimum balances in funds and accounts, see "SECURITY FOR THE BONDS." For a discussion of the process to obtain revised Bond Charges and Power Charges, see "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES."

Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs

Legal Challenges to Revenue Requirement Determinations

DWR's Bond Related Costs (including debt service on the Bonds) are payable primarily from Bond Charges, while DWR's Power Supply Program operating expenses (including Priority Contract Costs) are payable primarily from Power Charges. Bond Charges and Power Charges are established through an administrative process and, as part of that process, are subject to administrative and legal challenges by third parties. DWR believes that the possibility is remote that DWR would be prevented, as a result of any such challenges and the other circumstances described below, from paying debt service on the Bonds and other Bond Related Costs when due. There can be no guarantee, however, that such circumstances would not materially and adversely affect the ability of DWR to pay debt service on the Bonds and other Bond Related Costs when due.

In prior DWR revenue requirement proceedings, certain of the IOUs and other parties have asserted, among other things, that DWR's administrative revenue requirement process did not comply with the requirements of the DWR Revenue Requirement Regulations, that DWR did not provide adequate support and justification for its determinations that its revenue requirements are "just and reasonable," and that certain of DWR's costs included in its revenue requirements are not "just and reasonable." In the future, the IOUs or other parties could again challenge DWR's revenue requirements and its "just and reasonable" determinations.

DWR's Priority Long-Term Power Contracts require that payments by DWR under those contracts (including any termination payments that may be payable by DWR) are payable prior to payment of debt service on the Bonds. See "SECURITY FOR THE BONDS – Priority Long-Term Power Contracts." Accordingly, in the Indenture, DWR's pledge and assignment of its revenues from Bond Charges (and other funds available in the Bond Charge Collection Account) are subject to possible prior use for payment of Priority Contract Costs, as explained under "SECURITY FOR THE BONDS." The use of amounts on deposit in the Bond Charge Collection Account to pay Priority Contract Costs could occur, particularly if judicial review of DWR's determination of its revenue requirements were to result in DWR being prevented from including in its Retail Revenue Requirement all of its actual power costs or other operating expenses because any such costs or expenses were held not to be "just and reasonable." See "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – DWR Actions to Establish Revenue Requirements."

In the event that Power Charges imposed by the CPUC based on DWR's Retail Revenue Requirements and other amounts on deposit in the Operating Account are not sufficient to recover all of DWR's Priority Contract Costs, the Indenture requires that amounts be transferred from the Operating Reserve Account to pay Priority Contract Costs. See "SECURITY FOR THE BONDS – Operating Account" and "– Operating Reserve Account."

If a court were to determine that any of DWR's Priority Contract Costs were not "just and reasonable," DWR were prevented from including such Priority Contract Costs in its Retail Revenue Requirements and DWR were nevertheless obligated to pay such Priority Contract Costs, amounts in the Operating Account and Operating Reserve Account may be insufficient to pay such Priority Contract Costs and, as a result, the Indenture would require amounts to be transferred from the Bond Charge Collection Account to pay such Priority Contract Costs. See "SECURITY FOR THE BONDS – Accounts and Flow of Funds under the Indenture."

Application and Enforcement of CPUC's Bond Charge Rate Covenant

Under the Rate Agreement, the CPUC has covenanted to calculate, revise and impose from time to time, Bond Charges sufficient to provide moneys so that amounts available for deposit in the Bond Charge Payment Account under the Indenture from time to time, together with amounts on deposit in the Bond Charge Payment Account, are at all times sufficient to pay or provide for the payment of debt service on the Bonds and all other Bond Related Costs when due in

accordance with the Indenture and other financing documents (the "CPUC's Bond Charge Rate Covenant"). The Rate Agreement provides that this covenant shall have the force and effect of a "financing order" under the California Public Utilities Code and shall be irrevocable and enforceable in accordance with its terms, including, without limitation, in circumstances in which DWR has breached its obligations under the Rate Agreement or in respect of the Financing Documents. The CPUC decision adopting the Rate Agreement is final and unappealable under California law. Under the California Public Utilities Code, a "financing order" is binding upon the CPUC as it may be constituted from time to time, and the CPUC shall have no authority to rescind, alter or amend its obligations thereunder. Under the Act, the rights, powers and duties of the CPUC may not be diminished or impaired in a manner that would adversely affect the interests or rights of Bondholders. See "SECURITY FOR THE BONDS – Bond Related Costs" and "Rate Covenants" and "CALCULATION AND IMPOSITION OF BOND CHARGES AND POWER CHARGES – Rate Agreement."

Under the Indenture, DWR is obligated to "take such actions as shall be necessary and available to enforce all of the obligations required to be performed under [the] Rate Agreement by the [CPUC]." The Indenture further provides that DWR "shall commence such proceedings and take such other actions as may be necessary to assure compliance by the [CPUC] with the [CPUC's Bond Charge Rate Covenant] in the event that Bond Charge Revenues are applied to the payment of Priority Contract Costs for any reason." See APPENDIX C - "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Protection of Security."

However, any case involving interpretation or enforcement of the Rate Agreement would be the first case considering certain of the relevant legal questions under California law. Despite the terms of the Rate Agreement, it is possible that a court might, if asked to order the CPUC to comply with the CPUC's Bond Charge Rate Covenant, decline to give effect to the Rate Agreement in accordance with its literal terms if the effect of so doing would permit the recovery by DWR of power or bond costs that had been determined previously (in a legal challenge against DWR) not to be "just and reasonable." Any such court action could adversely affect the amount of revenues, including Bond Charge Revenues, available for the payment of the Bonds.

Transfer of amounts from the Bond Charge Collection Account to pay Priority Contract Costs could, in the absence of a sufficient increase in Bond Charges, result in a shortage of funds available in the Bond Charge Collection Account for transfer to the Bond Charge Payment Account for payment of debt service on the Bonds. Pursuant to the Indenture, if such a shortage occurred, any amounts available in the Debt Service Reserve Account would be used to pay debt service on the Bonds. There can be no assurance that the amount in the Debt Service Reserve Account would be sufficient in all such events to pay debt service on the Bonds and other Bond Related Costs. See "SECURITY FOR THE BONDS – Debt Service Reserve Account."

DWR's Assessment of these Risks

DWR believes, in light of (i) its determination that the costs included in its various revenue requirements are "just and reasonable," (ii) the provisions of the Act to the effect that DWR is entitled to recover, as a revenue requirement, amounts and at the times necessary to enable it to pay the costs listed in the Act, including debt service on bonds, power purchase costs, reserves determined by DWR to be appropriate and DWR administrative costs, (iii) the provisions of the Revenue Requirement Regulations incorporating those provisions of the Act into the factors to be considered in determining whether DWR's revenue requirements are just and reasonable, (iv) the operating reserves established under the Indenture, (v) the CPUC's Bond Charge Rate Covenant, and (vi) the debt service reserves established under the Indenture, that the possibility is remote that DWR would be prevented, as a result of the circumstances described above, from paying debt service on the Bonds and other Bond Related Costs when due. There can be no guarantee, however, that a court action as described above would not materially and adversely affect the ability of DWR to pay debt service on the Bonds and other Bond Related Costs when due.

Collection of Bond Charges and Power Charges

DWR does not have the personnel, equipment or customer information necessary to bill and collect Bond Charges and Power Charges from customers or to transmit and distribute power to customers as described under "THE DWR POWER SUPPLY PROGRAM – Collection of Revenues – *Summary of Servicing Arrangements*" and is dependent upon the IOUs to provide such services pursuant to the Servicing Arrangements. DWR believes there are no alternate servicers currently available, that alternate servicers may not be available in the future, and that it may not be feasible for any such servicers to perform effectively the services provided by the IOUs pursuant to the Servicing Arrangements. Moreover, even if an acceptable alternate servicer were identified, the transfer of responsibilities under a Servicing Arrangement also would

require regulatory approval from the CPUC, which might not be granted or which could result in additional delay. Accordingly, if one or more IOUs fails to perform or is excused by a court from performing under the Servicing Arrangements, DWR could experience a substantial delay in obtaining, or be unable to obtain, replacement services from an alternate source. A bankruptcy of an IOU could also lead to termination of its Servicing Agreement (see "Bankruptcy Risks – Potential Rejection of Servicing Agreements or Other Disruption of Servicing Arrangements" below). Any such problems could adversely affect the cash flow for the Power Supply Program and, ultimately, the ability of DWR to pay debt service on the Bonds. See "SECURITY FOR THE BONDS – Accounts and Flow of Funds under the Indenture" for information concerning reserve accounts established and required to be maintained under the Indenture to mitigate the impact of any cash flow shortfalls.

Bankruptcy Risks

Effect of IOU Bankruptcy on Remittance to DWR of Revenues From Bond Charges and Power Charges

DWR believes that all revenues from Bond Charges and Power Charges are the property of DWR and held in trust for DWR by the IOUs for purposes of California law and federal bankruptcy law. The Rate Agreement and the Act provide that Bond Charges and Power Charges are the property of DWR for all purposes under California law. The CPUC order authorizing the Rate Agreement is final and unappealable under California law.

It is possible that a bankrupt IOU could claim that the revenues collected by it for Bond Charges and Power Charges are property of its bankruptcy estate and are not held in trust for the benefit of DWR and could refuse to remit such revenues to DWR. PG&E, which emerged from Chapter 11 bankruptcy protection in 2003, did not make such a claim in its bankruptcy proceeding. Nonetheless, an IOU could assert an equitable and legal interest in the Power Charges and the Bond Charges and DWR can give no assurance as to whether or how long DWR or its creditors would be prevented from exercising their rights under relevant documents until the validity of such assertions are finally determined. DWR could be subject to a temporary restraining order, preliminary injunction or other interim relief affording delay pending a determination of the merits of an IOU's assertion. DWR revenues that are in possession of the IOU at the time of commencement of a bankruptcy case that have been commingled with property of the IOU could be treated as part of the IOU's bankruptcy estate. Finally, if revenues from Bond Charges and Power Charges were ultimately to be determined by a bankruptcy court to be property of an IOU's bankruptcy estate and not held in trust on behalf of DWR, DWR's efforts to collect such revenues might result in costly and time-consuming litigation.

Potential Rejection of or Other Disruption of Servicing Arrangements

As explained above under "Collection of Bond Charges and Power Charges," DWR's ability to collect Bond Charges and Power Charges is dependent on the IOUs acting in their capacities as servicers under the Servicing Arrangements. In the event of bankruptcy proceedings with respect to an IOU, the bankrupt IOU could move to reject its Servicing Agreement pursuant to the Bankruptcy Code. This rejection would require the approval of the bankruptcy court, and DWR and the CPUC could raise objections to such rejection. A successful rejection of the IOU's Servicing Agreement could result in DWR and the CPUC being unable to require the IOU to continue to collect and remit Bond Charges and Power Charges to DWR (or to provide any other services) under the Servicing Agreement after the date of rejection. However, the CPUC is required under the Act to order the IOU to provide such services upon request of DWR in the event the IOU's Servicing Agreement is rejected by an IOU in bankruptcy, thus replacing the Servicing Agreement with a servicing order similar to the servicing order in effect for PG&E. Although a bankrupt IOU subjected to a servicing order in this manner could challenge that order, either in its bankruptcy proceedings or under State law, DWR believes that the possibility is remote that such challenge would be successful or that the billing, collection and remittance of Bond Charges and Power Charges would be materially disrupted by such challenge.

A bankrupt IOU subject to a servicing order could seek relief from the servicing order in the bankruptcy court at any time and the bankruptcy court could grant such relief. The bankruptcy court could temporarily or permanently enjoin the CPUC from enforcing the order if the court determined that the order violated the automatic stay or other provisions of the Bankruptcy Code or could void the order altogether if it determined that the order was preempted by or otherwise violated the Bankruptcy Code or other provisions of federal law.

Uncertainties Relating to Electric Industry and Markets

The electric industry and markets in the western states region, including the governing laws and regulations, continue to face various uncertainties that create risk for the market in general and, in some cases, for DWR. Some of the general market uncertainties that exist include compliance with rapidly changing environmental, safety, licensing, regulatory and legislative requirements, volatility in fuel prices and electric energy prices, electric transmission and natural gas transmission constraints, and revisions in the CAISO market. Future changes in the electric industry and markets could have an adverse effect on DWR, its Power Supply Program or its ability to pay debt service on the Bonds.

The CAISO currently expects to implement their Market Redesign and Technology Upgrade ("MRTU") after the summer of 2008. Under the Locational Market Price ("LMP") provisions of MRTU, some uncertainty exists with respect to quantifying the effects of LMP on the revenue from off-system sales of excess DWR energy, and the IOUs' congestion costs associated with delivery of market contracts held by DWR. While there may be some increased price volatility in off-system sale prices after implementation of LMP under MRTU, the reduced projected contribution of off-system sales in future years reduces the effect of this volatility on overall DWR revenue requirement levels. Congestion costs related to delivery of DWR contract energy are anticipated to be paid by the IOUs. DWR is engaged in discussions with each IOU to align dispatch assumptions to assure the power charge revenue stream, and to help reduce the uncertainty of IOU exposure to congestion costs in their separate revenue requirements. The implementation of MRTU does not impact the Bond Charge.

Departing Load and Community Choice Aggregation

Unlike direct access, the growth of customer generation departing load and municipal departing load is not expressly limited by CPUC decision. However, to mitigate the shifting of costs to bundled customers, the CPUC has imposed a Cost Responsibility Surcharge on certain classes of municipal departing load and customer generation departing load customers, similar to the Cost Responsibility Surcharge imposed on certain direct access customers. DWR is allocated a portion of that Cost Responsibility Surcharge. The CPUC has granted a limited exemption from the Cost Responsibility Surcharge to clean distributed generation. The exemption is available to clean distributed generation not exceeding one megawatt and was extended to include the first megawatt of clean distributed generation from facilities with up to five megawatts of capacity. See "THE DWR POWER SUPPLY PROGRAM –Direct Access, Departing Load and Community Choice Aggregation– *Departing Load*." The CPUC has implemented tariffs authorizing the billing and collection of the Cost Responsibility Surcharge from municipal departing load customers. However, there is a risk that the IOUs will not be able to collect the Cost Responsibility Surcharge from all municipal departing load customers who are billed, particularly those customers who have no prior contractual relationship with the IOU.

In 2009 and beyond, the amount of Community Choice Aggregation load could increase significantly. The CPUC has issued orders in accordance with the California Public Utilities Code requiring that the Cost Responsibility Surcharge be paid by future Community Choice Aggregation customers.

Risk of Losing Load to Municipalization

Departing load (other than exempt departing load) and load related to Community Choice Aggregation are both required to pay their share of Bond Charges and Power Charges, such that even if these loads were not to receive energy from the IOUs, they would not adversely impact the per unit Power Charge and Bond Charge paid by the remaining IOU customers. This may not be the case if a portion of an IOU's service territory were municipalized. There is a risk that the current mechanisms in place to collect the Cost Responsibility Surcharge from municipal departing load may be challenged by a municipal entity that takes over a portion of an IOU delivery system and the corresponding load through eminent domain. The risk of this occurring, however, is believed to be small. While a few small portions of existing IOU service territories have been municipalized in the last 20 years, the last large successful municipalization occurred over 60 years ago when the Sacramento Municipal Utility District municipalized a portion of what was then PG&E territory. Even this municipalization took over 20 years to effectuate after voters approved the action. Recently, local support for municipalization of another portion of PG&E territory in Yolo County was defeated via referendum. It is likely that any attempt to municipalize any significant portion of an IOU's territory would be met with significant resistance from such IOU. Even if such efforts were undertaken and were successful, it is believed that it is unlikely that a municipal acquisition would be completed in less than 10 years from the time such efforts were initiated. However, no assurance can be given that such a municipal acquisition would not reduce the customer base from which Cost Responsibility Surcharges can be collected.

Uncertainties Relating to Government Action

Possible State Legislation or Action

The Act states that while any obligations of DWR incurred under the Act remain outstanding and are not fully performed or discharged, the rights, powers, duties, and existence of DWR and the CPUC shall not be diminished or impaired in any manner that will affect adversely the interests and rights of the holders of or parties to such obligations. This provision of the Act affords limited but not complete protection for the owners of Bonds against amendment of the Act and the Rate Agreement by legislation, action by the Governor under the Emergency Services Act, or voter initiative. Under California law, the electorate has the right, through its initiative powers, to propose statutes as well as amendments to the California Constitution. Generally, any matter that is a proper subject of legislation can become the subject of an initiative and be submitted to voters at the next general election.

Owners of the Bonds are entitled to the benefit of the prohibitions in Article I, section 10, of the Constitution of the United States (the "Contract Clause") against a state's impairment of the obligation of contracts. The prohibition, although not absolute, is particularly strong when applied to the State's attempt to evade its own obligations. Similar protections are afforded by Article I, Section 9, of the California Constitution.

Based on the U.S. Supreme Court's standard of review for Contract Clause challenges in Energy Reserves Group, Inc. v. Kansas Power & Light Co., the State must justify the exercise of its inherent police power to safeguard the vital interests of its people before the State may alter the Act, the Indenture or the Rate Agreement in a manner that would substantially impair the rights of the Owners of the Bonds. However, to justify the enactment by the State of legislation that substantially impairs the contractual rights of the Bondholders, the State must demonstrate a significant and legitimate public purpose, such as the remedying of a broad and general social or economic problem. In the event that the State demonstrates a significant and legitimate public purpose for such legislation, the State must also show that the impairment of the Bondholders' rights is reasonable and appropriate to the public purpose justifying the legislation's adoption.

There have been cases in which legislative concerns with the burden of taxation or governmental charges have led to adoption of legislation reducing, eliminating or imposing a moratorium on taxes or charges that supported bonds or other contractual obligations entered into by public instrumentalities. Such concerns have not been considered by the courts to provide sufficient justification for a substantial impairment of the security for such bonds and other contractual obligations and, in several cases, have held such legislation as an unconstitutional impairment of contract.

Nonetheless, a repeal, amendment or suspension of, or moratorium on, certain provisions of the Act, the Indenture or the Rate Agreement could be sought or adopted, even if such repeal, amendment, suspension or moratorium might constitute a violation of the Indenture or the Rate Agreement. Additionally, the State might take, or refuse to take, or cause DWR or the CPUC to take, or refuse to take, action required of DWR under the Indenture or of DWR or the CPUC under the Rate Agreement, even if such action or inaction might constitute a violation of the Indenture or the Rate Agreement. Costly and time-consuming litigation might ensue which might adversely affect the price and liquidity of the Bonds and the timely payment thereof. Moreover, the outcome of such litigation might be adverse to the interests of owners of the Bonds, and accordingly, owners of the Bonds could experience a decline in value of their investment as a result of any such event.

Possible Federal Legislation or Action

Congress could enact new legislation or FERC could adopt new regulations with respect to the electric industry and markets in the western states region that could adversely affect the payment of debt service on the Bonds. For example, FERC could approve new rules that increase or shift a greater portion of the costs of transmitting the power sold by DWR to retail customers. Such a change could adversely impact the cash flow for the Power Supply Program and possibly requiring the temporary use of Bond Charge Revenues to pay amounts due under DWR's Priority Long-Term Power Contracts (as described above under "Determination of Power Charges and Bond Charges; Possible Use of Amounts in the Bond Charge Collection Account to Pay Priority Contract Costs") instead of debt service on the Bonds.

The provisions of the United States Constitution discussed under "Possible State Legislation or Action" above, affording protection against contract impairments by State action to the owners of the Bonds, do not apply to the federal government. While the Due Process Clause of the United States Constitution protects against certain contract impairments by the federal government, the Due Process Clause may not adequately protect owners of the Bonds against adverse effects of federal legislation or action.

Uncertainty of Projections and Assumptions

General

This Official Statement includes projections that are dependent upon projections and assumptions about, among other things, system transmission operations and capacity, weather trends, generation capacity, fuel costs, spot market prices for energy and energy consumption. In addition, the determination of DWR's revenue requirements involves the making of similar projections and assumptions. These projections and assumptions are subject to risks and uncertainties, including risks and uncertainties outside the control of DWR. The accuracy of such projections and assumptions is subject to known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from such projections and assumptions. Differences in actual results from projections may be difficult to recognize in a timely manner for purposes such as the adjustment of DWR's revenue requirements. Material differences could result in a variety of unpredictable consequences which could adversely affect the Power Supply Program and the ability of DWR to pay debt service on the Bonds.

This Official Statement also assumes future approvals and other actions by a number of governmental entities that regulate the energy industry, including the CPUC, FERC and the California Energy Commission. If such approvals or other actions do not occur or do not occur on a timely basis, the ability of DWR to make timely payment of debt service on the Bonds could be materially and adversely affected. In addition, DWR must act in a timely manner to revise its revenue requirements in order to conform to the assumptions made in this Official Statement.

CPUC Disclaimer

The CPUC makes no representation as to the accuracy or completeness of this Official Statement, including any forward-looking statements or projections contained in this Official Statement and any description in this Official Statement of litigation involving or affecting the CPUC. Any statements regarding such litigation do not necessarily represent the CPUC's view of such litigation or any position in such litigation. In addition, while CPUC staff may have assisted in the preparation of certain sections of this Official Statement, the CPUC can only take positions through formal action and has not taken any such action or approved this Official Statement. The CPUC is an independent five member body that must act by an affirmative vote of a majority of its members and, as a result, the CPUC can only indicate its views in formal decisions or other formal actions. In addition, the CPUC is an independent body not subject to the control of DWR and may take positions in the future different from DWR in litigation, or other matters described in this Official Statement. As a result, statements in this Official Statement regarding electricity markets and regulation, and DWR's views of the CPUC's role or DWR's role in such markets and regulation, do not necessarily represent the views, opinions or beliefs of the CPUC and should not be construed as such by any recipient of this Official Statement.

Limited Obligations

The Bonds shall not be or be deemed to constitute a debt or liability of the State or of any political subdivision thereof or a pledge of the faith and credit of the State or of any such political subdivision, other than DWR to the extent provided in the Indenture. The Bonds shall be payable solely from the funds pledged therefor pursuant to the Indenture. The Bonds shall not directly or indirectly or contingently obligate the State or any political subdivision thereof to levy or to pledge any form of taxation whatever therefor or to make any appropriation for their payment.

Uncertainties of Financial Markets

Uncertainties, disruptions or volatility in the financial markets, including but not limited to, credit or liquidity provider credit rating downgrades, swap provider credit rating downgrades, defaults under swap agreements, substantial fund flows into or out of the market for variable rate bonds, and other factors might affect market rates for variable rate bonds and the rates on DWR's variable rate bonds.

FINANCIAL STATEMENTS

The financial statements of the Department of Water Resources Electric Power Fund at June 30, 2007 and June 30, 2006 appearing in Appendix A to this Official Statement have been audited by PricewaterhouseCoopers LLP, independent auditors, as set forth in their report appearing in Appendix A.

RATINGS

Moody's Investors Service ("Moody's"), Standard & Poor's Ratings Group, a division of The McGraw-Hill Companies, Inc. ("Standard & Poor's") and Fitch, Inc., doing business as FitchRatings, have assigned ratings of Aa3, A and A+, respectively, to the Series 2008K Bonds. An explanation of the significance of these ratings may be obtained from Moody's at 250 Greenwich Street, 23rd Floor, New York, New York 10007, from Standard & Poor's at 55 Water Street, New York, New York 10041 and from Fitch Ratings at One State Street Plaza, New York, New York 10004. Such ratings reflect only the views of the rating agencies.

Generally, rating agencies base their ratings on such information and materials and on investigations, studies and assumptions made by the rating agencies themselves. There is no assurance that the ratings mentioned above will remain in effect for any given period of time or that the ratings might not be lowered or withdrawn entirely by the rating agencies, if in their judgment circumstances so warrant. DWR and the Underwriters have undertaken no responsibility to oppose any such proposed revision or withdrawal. DWR has agreed to notify the Municipal Securities Rulemaking Board or each Nationally Recognized Municipal Securities Information Repository and the State Repository, if any, of any change in the ratings of the Series 2008K Bonds. See "CONTINUING DISCLOSURE" herein. Any such downward change in or withdrawal of the ratings might have an adverse effect on the market price or marketability of the Series 2008K Bonds.

UNDERWRITING

The Series 2008K Bonds will be purchased by an underwriting group represented by J.P. Morgan Securities Inc. (collectively called the "Underwriters") from the State Treasurer, who is authorized pursuant to the laws of the State to sell the Series 2008K Bonds on behalf of DWR. The Underwriters have agreed to purchase the Series 2008K Bonds for the principal amount thereof plus $18,302,966.00 of net original issue premium, less an underwriting discount of $1,463,008.69. The purchase contract pursuant to which the Series 2008K Bonds are being sold provides that the Underwriters will purchase all of the Series 2008K Bonds if any are purchased. The obligation to make such purchase will be subject to certain terms and conditions set forth in such purchase contract, the approval of certain legal matters by counsel and certain other conditions.

FINANCIAL ADVISOR

Montague DeRose and Associates, LLC served as financial advisor to DWR in connection with the Series 2008K Bonds.

APPROVAL OF LEGAL MATTERS

The issuance of the Series 2008K Bonds is subject to the approving opinions of the Honorable Edmund G. Brown Jr., Attorney General of the State, and Hawkins Delafield & Wood LLP, Bond Counsel to DWR. The proposed forms of such opinions are set forth in Appendix E and Appendix F to this Official Statement. Certain legal matters will be passed upon by: David Sandino, Chief Counsel to DWR; Orrick, Herrington & Sutcliffe LLP, disclosure and special counsel to DWR; Lionel B. Wilson, Interim General Counsel to the CPUC; Paul, Weiss, Rifkind, Wharton & Garrison LLP, Special Counsel to the CPUC and Nixon Peabody LLP, counsel to the Underwriters.

RELATIONSHIPS

The Power Supply Program and related activities, including the sale of Bonds, has been made possible, in part, by hiring underwriters, financial advisors, consultants and lawyers to assist and advise DWR. Many of the firms and individuals involved in this effort have prior or ongoing relationships with the IOUs, other investor-owned utilities, public power utilities and other businesses that contract or compete with DWR or contract with the State and other State agencies or that may do so in the future. DWR has required disclosure of, and has taken into account, these relationships and has determined it to be in the best interests of DWR to continue to work with these firms and individuals.

In addition, in the ordinary course of sales, trading, brokerage and financing activities, certain of the Underwriters may at any time hold long or short positions, and may trade or otherwise effect transactions, for their own accounts or the accounts of customers, in debt or equity securities or senior loans, as applicable, of DWR, the State of California, other State agencies, the IOUs, power suppliers, municipal utilities and other participants in the electric power industry. In connection with these activities and the provision of other services, certain of the Underwriters may be or become creditors of such

entities. In addition, many of the Underwriters, or their affiliates, currently serve as remarketing agents or providers of credit enhancement or liquidity facilities for variable rate obligations issued by, or as interest rate swap providers to, DWR, the State of California and other State agencies.

TAX MATTERS

In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to DWR with respect to this financing, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Series 2008K Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) interest on the Series 2008K Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering its opinion, Bond Counsel has relied on certain representations, certifications of fact, and statements of reasonable expectations made by DWR in connection with the Series 2008K Bonds, and Bond Counsel has assumed compliance by DWR with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of interest on the Series 2008K Bonds from gross income under Section 103 of the Code.

In addition, in the opinion of Bond Counsel to DWR with respect to this financing, under existing statutes, interest on the Series 2008K Bonds is exempt from State of California personal income taxes. See "Miscellaneous" below for a discussion of certain litigation that may relate to this State tax exemption.

Bond Counsel expresses no opinion regarding any other federal or state tax consequences with respect to the Series 2008K Bonds. Bond Counsel renders its opinion under existing statutes and court decisions as of the issue date, and assumes no obligation to update its opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. Bond Counsel expresses no opinion on the effect of any action hereafter taken or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for federal income tax purposes of interest on the Series 2008K Bonds, or under state and local tax law.

Certain Ongoing Federal Tax Requirements and Covenants

The Code establishes certain ongoing requirements that must be met subsequent to the issuance of the Series 2008K Bonds in order that interest on the Series 2008K Bonds be and remain excluded from gross income under Section 103 of the Code. These requirements include, but are not limited to, requirements relating to use and expenditure of gross proceeds of the Series 2008K Bonds, yield and other restrictions on investments of gross proceeds, and the arbitrage rebate requirement that certain excess earnings on gross proceeds be rebated to the federal government. Noncompliance with such requirements may cause interest on the Series 2008K Bonds to become included in gross income for federal income tax purposes retroactive to their issue date, irrespective of the date on which such noncompliance occurs or is discovered. DWR has covenanted to comply with certain applicable requirements of the Code to assure the exclusion of interest on the Series 2008K Bonds from gross income under Section 103 of the Code.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain collateral federal income tax matters with respect to the Series 2008K Bonds. It does not purport to address all aspects of federal taxation that may be relevant to a particular owner of a Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the federal tax consequences of owning and disposing of the Series 2008K Bonds.

Prospective owners of the Series 2008K Bonds should be aware that the ownership of such obligations may result in collateral federal income tax consequences to various categories of persons, such as corporations (including S corporations and foreign corporations), financial institutions, property and casualty and life insurance companies, individual recipients of Social Security and railroad retirement benefits, individuals otherwise eligible for the earned income tax credit, and taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is not included in gross income for federal income tax purposes. Interest on the Series 2008K Bonds may be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Original Issue Discount

"Original issue discount" ("OID") is the excess of the sum of all amounts payable at the stated maturity of a Bond (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates) over the issue price of that maturity. In general, the "issue price" of a maturity means the first price at which a substantial amount of the Series 2008K Bonds of that maturity or portion thereof bearing a particular interest rate was sold (excluding sales to bond houses, brokers, or similar persons acting in the capacity as underwriters, placement agents, or wholesalers). In general, the issue price for the Series 2008K Bonds or portion thereof bearing a particular interest rate is expected to be the initial public offering price set forth on the inside cover page of the Official Statement. Bond Counsel further is of the opinion that, for any Series 2008K Bonds having OID (a "Discount Bond"), OID that has accrued and is properly allocable to the owners of the Discount Bonds under Section 1288 of the Code is excludable from gross income for federal income tax purposes to the same extent as other interest on the Series 2008K Bonds.

In general, under Section 1288 of the Code, OID on a Discount Bond accrues under a constant yield method, based on periodic compounding of interest over prescribed accrual periods using a compounding rate determined by reference to the yield on that Discount Bond. An owner's adjusted basis in a Discount Bond is increased by accrued OID for purposes of determining gain or loss on sale, exchange, or other disposition of such Bond. Accrued OID may be taken into account as an increase in the amount of tax-exempt income received or deemed to have been received for purposes of determining various other tax consequences of owning a Discount Bond even though there will not be a corresponding cash payment.

Owners of Discount Bonds should consult their own tax advisors with respect to the treatment of original issue discount for federal income tax purposes, including various special rules relating thereto, and the state and local tax consequences of acquiring, holding, and disposing of Discount Bonds.

Bond Premium

In general, if an owner acquires a Bond for a purchase price (excluding accrued interest) or otherwise at a tax basis that reflects a premium over the sum of all amounts payable with respect to the Bond after the acquisition date (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates), that premium constitutes "bond premium" on that Bond (a "Premium Bond"). In general, under Section 171 of the Code, an owner of a Premium Bond must amortize the bond premium over the remaining term of the Premium Bond, based on the owner's yield over the remaining term of the Premium Bond determined based on constant yield principles (in certain cases involving a Premium Bond callable prior to its stated maturity date, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such bond). An owner of a Premium Bond must amortize the bond premium by offsetting the qualified stated interest allocable to each interest accrual period under the owner's regular method of accounting against the bond premium allocable to that period. In the case of a tax-exempt Premium Bond, if the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to that accrual period, the excess is a nondeductible loss. Under certain circumstances, the owner of a Premium Bond may realize a taxable gain upon disposition of the Premium Bond even though it is sold or redeemed for an amount less than or equal to the owner's original acquisition cost. Owners of any Premium Bonds should consult their own tax advisors regarding the treatment of bond premium for federal income tax purposes, including various special rules relating thereto, and state and local tax consequences, in connection with the acquisition, ownership, amortization of bond premium on, sale, exchange, or other disposition of Premium Bonds.

Information Reporting and Backup Withholding

Information reporting requirements apply to interest paid on tax-exempt obligations, including the Series 2008K Bonds. In general, such requirements are satisfied if the interest recipient completes, and provides the payor with, a Form W-9, "Request for Taxpayer Identification Number and Certification," or unless the recipient is one of a limited class of exempt recipients, including corporations. A recipient not otherwise exempt from information reporting who fails to satisfy the information reporting requirements will be subject to "backup withholding," which means that the payor is required to deduct and withhold a tax from the interest payment, calculated in the manner set forth in the Code. For the foregoing purpose, a "payor" generally refers to the person or entity from whom a recipient receives its payments of interest or who collects such payments on behalf of the recipient.

If an owner purchasing a Bond through a brokerage account has executed a Form W-9 in connection with the establishment of such account, as generally can be expected, no backup withholding should occur. In any event, backup withholding does not affect the excludability of the interest on the Series 2008K Bonds from gross income for federal income tax purposes. Any amounts withheld pursuant to backup withholding would be allowed as a refund or a credit against the owner's federal income tax once the required information is furnished to the Internal Revenue Service.

Miscellaneous

Tax legislation, administrative actions taken by tax authorities, and court decisions, whether at the federal or state level, may adversely affect the tax-exempt status of interest on the Series 2008K Bonds under federal or state law and could affect the market price or marketability of the Series 2008K Bonds.

Prospective purchasers should be aware that the United States Supreme Court has agreed to review *Davis v. Dep't. of Revenue of the Finance and Admin. Cabinet*, 197 S.W. 3d 557 (Ky. App. 2006), *cert. granted* 2007 U.S. LEXIS 5914 (May 21, 2007), a decision of a Kentucky appellate court, which held that provisions of Kentucky tax law that provided more favorable income tax treatment for holders of bonds issued by Kentucky municipal bond issuers than for holders of non-Kentucky municipal bonds violated the Commerce Clause of the United States Constitution. California statutes provide more favorable California income tax treatment for holders of bonds issued by the State of California and its political subdivisions, including the Series 2008K Bonds, than for bonds issued by other states and their political subdivisions. If the United States Supreme Court were to affirm the holding of the Kentucky appellate court, subsequent California judicial decisions or legislation designed to ensure the constitutionality of California tax law could, among other alternatives, adversely affect the California tax exemption of outstanding bonds, including the Series 2008K Bonds, to the extent constitutionally permissible, or result in the exemption from California income tax of interest on certain bonds issued by other states and their political subdivisions, either of which actions could affect the market price or marketability of the Series 2008K Bonds.

Prospective purchasers of the Series 2008K Bonds should consult their own tax advisers regarding the foregoing matters.

CONTINUING DISCLOSURE

DWR will covenant for the benefit of the holders and beneficial owners of the Series 2008K Bonds to provide certain financial information and operating data relating to DWR (the "Annual Report") by not later than 270 days following the end of DWR's fiscal year (which ends June 30) and to provide notices of the occurrence of certain enumerated events, if material. The Annual Report will be filed by DWR with each nationally recognized municipal securities information repository certified by the Securities and Exchange Commission (the "Repositories"). The notices of material events will be filed by DWR with the Municipal Securities Rulemaking Board or the Repositories. The specific nature of the information to be contained in the Annual Report or the notices of material events is described in the Continuing Disclosure Certificate. The Continuing Disclosure Certificate is subject to amendment as described therein. The proposed form of the Continuing Disclosure Certificate is attached hereto as APPENDIX H - "FORM OF CONTINUING DISCLOSURE CERTIFICATE."

Under the Indenture, DWR has agreed to post on its website, so long as it maintains a website, or to send to any person requesting the same in writing if it no longer maintains a website, (i) within 45 days of the end of each fiscal year quarter (except the fourth quarter), unaudited financial statements of the Electric Power Fund for such quarter, (ii) within 120 days after the end of each fiscal year, audited financial statements of the Electric Power Fund for such fiscal year and (iii) promptly, each revenue requirement submitted to the CPUC. See APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Continuing Disclosure."

Pursuant to the Indenture, failure of DWR to comply with its continuing disclosure obligations under the Continuing Disclosure Certificate or under the Indenture will not be considered an event of default under the Indenture. However, the Trustees, or any Bondholder or Beneficial Owner (as defined in the Continuing Disclosure Certificate) may seek specific performance by court order, to cause DWR to comply with its continuing disclosure obligations under the Continuing Disclosure Certificate or under the Indenture, as the sole remedy. DWR has complied in all material respects with all previous similar undertakings under continuing disclosure certificates.

AUTHORIZATION

The delivery of this Official Statement, including the Appendices and other information herein, has been duly authorized by DWR.

STATE OF CALIFORNIA
DEPARTMENT OF WATER RESOURCES

By: /s/ Lester A. Snow
Director of Water Resources

APPENDIX A

AUDITED FINANCIAL STATEMENTS OF THE ELECTRIC POWER FUND FOR THE YEARS ENDED JUNE 30, 2007 AND 2006 AND REPORT OF INDEPENDENT AUDITORS

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Department of Water Resources
Electric Power Fund
Financial Statements

For the years ended June 30, 2007 and 2006

California
Energy
Resources
Scheduling
Department of
Water Resources

Department of Water Resources Electric Power Fund
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PRICEWATERHOUSECOOPERS

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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, 2007 and 2006, 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 opinions.

As discussed in Note 2, the financial statements of the Fund, are intended to present the financial position, and the changes in financial position and cash flows, 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 at June 30, 2007 and 2006, and the changes in its financial position and its cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis presented on pages 2 through 8 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

September 26, 2007

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. Over 95% of the volume of power under contract expires by December 31, 2011 and the last of the contracts expires in 2015.

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

STATUS OF BLOCK FORWARD CONTRACTS LITIGATION

In early 2001, the State commandeered block forward contracts between the California Power Exchange and six suppliers. DWR paid approximately $352 million for energy provided under the contracts, which expired in December 2001. Certain market participants claimed they were entitled to damages in excess of $1 billion, their estimation of the fair value of the block forward contracts at the time of commandeering. In March 2007, the principal plaintiff, the California Power Exchange, dismissed its action against the State. Another plaintiff dismissed its claim in May 2007, leaving one plaintiff whose claim is not material.

Should the State be found liable for the remaining claim, and the Fund determined to be the source of moneys to pay damages, those damages would be recoverable from ratepayers through future DWR revenue requirements.

STATEMENT OF NET ASSETS

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

	2007	2006	2005
Long-term restricted cash, equivalents and investments	$ 1,542	$ 1,501	$ 1,482
Recoverable costs, net of current portion	6,503	7,229	7,356
Restricted cash and equivalents:			
Operating and priority contract accounts	1,167	950	1,387
Bond charge collection and bond charge payment accounts	549	514	570
Recoverable costs, current portion	610	613	573
Interest receivable	41	33	26
Other assets	91	75	80
Total assets	$ 10,503	$ 10,915	$ 11,474
Net assets	$ -	$ -	$ -
Long-term debt, including current portion	9,995	10,465	10,982
Other current liabilities	508	450	492
Total capital and liabilities	$ 10,503	$ 10,915	$ 11,474

Long-Term Restricted Cash and Investments

The $41 million increase in long-term restricted cash and investments during fiscal 2007 is a combination of a $21 million increase in the Operating Reserve Account and a $20 million increase in Debt Service Reserve Account. The Operating Reserve Account was increased to $612 million to maintain the balance at a level determined in accordance with the bond indenture and is equal to twelve percent of the Fund's projected 2007 calendar year annual operating expenses as forecast in the DWR 2007 revenue requirement. The Debt Service Reserve Account was increased to $930 million due to higher interest rate assumptions for variable rate debt in the 2007 revenue requirement.

The net $19 million increase in long-term restricted cash and investments during 2006 is a combination of a $36 million increase in the Operating Reserve Account and a $17 million decrease in Debt Service Reserve Account. The increase in the Operating Reserve Account is due primarily to forecasted increases in natural gas costs which raised the balance to $591 million and is equal to twelve percent of projected annual operating expenses for calendar year 2006. The $17 million decrease in the Debt Service Reserve Account to $910 million is a result of issuing refunding bonds as described in the Long-Term Debt section below.

Recoverable Costs, Net of Current Portion

Long-term recoverable costs consist of costs that are recoverable through future billings. The $726 million decrease during fiscal 2007 is due to 1) operating revenues exceeding operating expenses by $128 million, and 2) bond charges plus interest income exceeding interest expense by $598 million.

The $127 million decrease during fiscal 2006 is net of 1) operating expenses exceeding operating revenues by $413 million, and 2) bond charges plus interest income exceeding interest expense by $540 million. Operating expenses exceeded operating revenue for 2006 due to the higher cost of natural gas than forecast, and the ability to decrease power charges for the first six months of the fiscal year through the calendar 2005 revenue requirement process and still maintain operating funds in excess of the amount required by the bond indenture.

Restricted Cash and Investments

The Operating and Priority Contract Accounts increased by $217 million in 2007 due to higher remittance rates in 2007, lower than forecast natural gas costs, and the receipt of $47 million in non-forecasted energy settlements. The $1,167 million balance in the Operating and Priority Contract Accounts at June 30, 2007 is $92 million higher than forecast in DWR's calendar 2007 revenue requirement determination.

The Operating and Priority Contract Accounts decreased by $437 million in 2006 due to a planned decrease of $576 million, receipt of $288 million in non-forecasted energy settlements, and a $149 million increase in natural gas costs over what had been forecast. The $950 million balance in the Operating and Priority Contract Accounts at June 30, 2006 is $139 million higher than forecast in DWR's calendar 2006 revenue requirement determination.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $35 million in 2007 due to higher than expected interest earned on balances and lower than forecast debt service costs in the stable interest rate environment.

The Bond Charge Collection and Bond Charge Payment Accounts decreased by $56 million in 2006. This is attributable to a $42 million reduction as part of the bond refinancing in December 2005, discussed further in the Long-Term Debt section below, and a $21 million planned reduction in the combined 2006 and 2005 revenue requirements.

From the dates of issuance of the revenue bonds through June 30, 2007, the balances in each of the restricted cash and investments accounts met or exceeded balances required by the bond indenture.

Recoverable Costs, Current Portion

The current portion of recoverable costs reflects power and bond charges to IOU customers that have not yet been collected and amounts due for surplus sales of energy and gas. The current portion of recoverable costs at June 30, 2007 is $3 million lower than at June 30, 2006, reflecting lower surplus sales volumes and the implementation of an 8% reduction of remittance rates in January 2007 through the 2007 revenue requirement process offsetting the 5% higher delivered volumes in the second half of fiscal 2007 over the same period in 2006.

The current portion of recoverable costs at June 30, 2006, is $40 million higher than at June 30, 2005, primarily due to higher remittance rates implemented at the beginning of calendar year 2006 resulting from increased natural gas prices and their impact on the 2006 revenue requirement.

Other Assets

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

During 2007, other assets increased by $16 million. DWR funded the account with $45 million in September 2006 to enable future hedging transactions. At June 30, 2007, the account consists of money market obligations, US Treasury bills and government bonds valued at $39 million and financial options valued at $52 million. At June 30, 2007, DWR has open positions with an unrealized marked-to-market value decrease of $25 million, with the price environment being stable but lower since the high prices in fall 2005 and winter 2006, and the risk premium built into the market deflating with the passage of time. During 2006, other assets declined by $5 million. Also in 2006, DWR funded the account with an additional $125 million to collateralize unrealized losses and enable future hedging.

Long-Term Debt

Revenue bond principal payments were $447 million and $436 million in fiscal 2007 and 2006, respectively. Net amortization of bond premium and deferred loss on defeasance were $23 million and $32 million in fiscal 2007 and 2006, respectively.

In December 2005, DWR issued an aggregate $2.594 billion in variable rate refunding revenue bonds (Series F and G) to advance refund $2.353 billion of outstanding 2002 Series A fixed rate bonds.

The proceeds of the refunding bonds, along with funds released from the Bond Charge Payment Account ($42 million) and Debt Service Reserve Account ($17 million), were used to purchase securities that were deposited in an irrevocable trust with an escrow agent to provide for future debt service payments on the advance refunded bonds and pay for underwriting fees and other issuance costs. As a result, the advance refunded bonds are considered to be defeased and the related liabilities have been removed from the financial statements.

The refunding resulted in an accounting loss of $218 million which has been deferred over the life of the refunded debt. However, the Fund effectively reduced its aggregate debt service payments by approximately $278 million through 2022 and achieved an economic gain (difference between the present values of the old and new debt service payments) estimated at the date of bond issuance to be $145 million. The actual economic gain will be dependent on basis risk associated with the interest rate swaps described in the following paragraph.

In anticipation of the refunding, DWR entered into interest-rate swap agreements based on the London Inter-Bank Offered Rate (LIBOR) with a notional amount of $2.594 billion to pay fixed rates of interest and receive floating rate payments. The result is that the debt service on the refunding bonds is effectively fixed for the life of the bonds.

Other Current Liabilities

Accounts payable at June 30, 2007 are $59 million higher than at June 30, 2006, reflecting slightly higher energy contract volumes. Accounts payable at June 30, 2006 and 2005 are comparable.

Accrued interest payable at June 30, 2007 is $1 million lower than at June 30, 2006 as interest rates were stable during 2007. Accrued interest payable at June 30, 2006 is $12 million less than at June 30, 2005. The decrease is attributable to the refunding described in the Long-Term Debt section above which resulted in defeasance of $2.7 billion fixed rate debt, having semi-annual interest payments, with variable rate debt that is paid monthly.

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

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

	2007	2006	2005
Revenues:			
Power charges	$ 4,433	$ 3,890	$ 4,263
Surplus sales	410	480	451
Bond charges	855	842	845
Interest income	167	130	96
Total revenues	5,865	5,342	5,655
Expenses:			
Power purchases	4,732	5,038	4,965
Energy settlements	(47)	(288)	(191)
Interest expense	424	432	436
Other expenses	30	33	56
Recovery of recoverable costs	726	127	389
Total expenses	5,865	5,342	5,655
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 were $543 million higher in 2007 than in 2006. Although the volume of power sold in each year was substantially the same, the average remittance rate was 12% higher in fiscal year 2007 than in 2006. Rates for the first six months of fiscal 2007 were 37% higher than in the same period in fiscal 2006 due to an anticipated increase in fuel costs for the full calendar year 2006. Rates effective January 2007 with the implementation of the 2007 revenue requirement are 8% lower than those in place during calendar 2006, as a result of lower anticipated fuel costs for the full 2007 calendar year.

Power charges decreased by $373 million in 2006 to $3.890 billion as compared to 2005. The lower amount reflects 7% less power sold throughout the year to end use customers as a major contract expired in December 2004, and decreased dispatchable peaking plant contract volumes due to milder temperatures in the first quarter of fiscal 2006.

Surplus Sales

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

Surplus sales of energy and natural gas in fiscal 2007 are $70 million lower than in fiscal 2006, reflecting lower natural gas prices when compared to the hurricane related high price environment in late calendar 2005. There was also a decline in quantities of surplus energy sold during 2007 compared to 2006, as a

result of increased consumption of power by ratepayers during the summer months. This quantity decrease was partially offset by higher prices received for surplus sales.

Surplus sales revenues are $29 million higher in 2006 than in 2005. The increase is attributable to the higher price of natural gas for surplus gas sales offset by lower sales volumes of excess contract energy. The high prices for natural gas in 2006 resulted in a 65% rise in amounts received for the sales of surplus gas as compared to 2005. This was offset by 14% lower sales of excess energy. The lower surplus energy sales were attributable to 32% lower volumes sold offset by 29% higher prices received for volumes sold.

Bond Charges

Bond charges provide revenue for the payment of debt service on the revenue bonds and are determined by applying a CPUC adopted rate to the total megawatt hours of power delivered to all IOU customers and certain ESP customers. Bond charges for the years ended June 30, 2007, 2006 and 2005 were $855 million, $842 million, and $845 million, respectively, and were adequate to meet all debt service requirements and maintain bond indenture required account balances in the Bond Charge Collection, Bond Charge Payment, and Debt Service Reserve Accounts.

Interest Income

Interest income for 2007 was $37 million higher than in 2006, and interest income for 2006 was $34 million higher than in 2005. These increases are attributable to increased interest earned on investments in the State of California Investment Pooled Money Investment Account-Surplus Investment Fund (SMIF) and larger cash and investment balances.

Power Purchases

Power costs are $293 million lower in 2007 than in 2006. This decrease is primarily attributable to lower natural gas costs in 2007, partially offset by 3% higher contract volumes in 2007. Gas costs in 2006 were higher because of the hurricane related high price environment.

Power costs increased by $74 million in 2006 as compared to 2005 as higher prices for natural gas increased variable costs, resulting in higher per megawatt hour prices. The gas purchased to produce power was $300 million higher in 2006 as compared to 2005, a 23% increase. The impact of higher fuel prices on total power costs was offset by a 7% decrease in volume of energy purchased and sold to ratepayers.

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 2007 total $47 million. DWR received $23 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 energy settlements at such time as there is a distribution of monies. The Fund received an additional $24 million in other settlements, including $18 million from BP Energy Company.

Energy settlements in 2006 total $288 million. First, as part of the energy settlement with Mirant Corporation in 2005, DWR received unsecured claims totaling $90 million plus accrued interest in the Mirant Corporation bankruptcy case. In December 2005, DWR sold its claims and received $96 million. Second, the energy settlement with Enron Corp. became effective and DWR received $53 million. In addition, an energy settlement with Reliant Energy became effective in December 2005 and $66 million

was received in March 2006. Finally, in May, 2006, DWR received $73 million from an arbitration agreement with Sempra Energy Resources.

Energy settlements of $191 million recognized in 2005 include $99 million from Dynegy Inc., $76 million from Mirant Corporation, $14 million from Duke Energy Corporation, plus an additional $2 million from the 2004 settlement with El Paso Corporation.

Future revenues under the Mirant Corporation, Reliant Energy, Dynegy Inc, and Duke Energy Corporation settlements are subject to conditions outlined in the underlying settlement and allocation agreements.

Interest Expense

Interest expense declined $8 million in 2007 as compared to 2006. The net decrease is attributable to the December 2005 financing described in the following paragraph, reduced by higher interest rates on variable rate debt in 2007 as compared to 2006.

Interest expense declined $4 million in 2006 as compared to 2005. The December 2005 refinancing defeased fixed rate debt with rates ranging from 5.125% to 6% with variable rate debt that was effectively converted to fixed rate debt through interest rate swaps with fixed interest rates approximating 3.3%. This decrease in interest costs was partially offset by higher interest rates on other variable rate debt.

Other Expenses

Other expenses declined by $3 million in 2007 as a result of decreased costs for contract renegotiation, litigation and professional consulting services. Other expenses declined by $23 million in 2006. Approximately $14 million of the reduction reflects a decrease in charges for services provided to the Power Supply Program by other State agencies. The remaining decrease is attributable to decreased costs for contract renegotiation and litigation.

Recovery (Deferral) of Recoverable Costs

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

	2007	2006	2005
Operations	$ 128	$ (413)	$ (116)
Debt service and related costs	598	540	505
	$ 726	$ 127	$ 389

Operations
The $128 million recovery of recoverable costs in the year ended June 30, 2007 reflects 1) lower than forecasted natural gas costs and 2) the unplanned receipt of settlement funds.

The $413 million deferral in the year ended June 30, 2006 reflected 1) greater than forecast natural gas costs, and 2) the planned under recovery of calendar 2005 operating costs while maintaining compliance with bond indenture requirements.

The $116 million deferral in 2005 is also attributable to DWR's ability to reduce power charges and still maintain operating funds that are in excess of the amount required by the bond indentures.

Debt Service and Related Costs
The recovery in all three years is anticipated as bond charges and interest income provide funds to pay interest expense and retire debt.

Department of Water Resources Electric Power Fund
Statements of Net Assets
June 30, 2007 and 2006 (in millions)

	2007	2006
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 612	$ 591
Debt Service Reserve Account	930	910
Recoverable costs, net of current portion	6,503	7,229
Total long-term assets	8,045	8,730
Current assets:		
Restricted cash and equivalents:		
Operating and Priority Contract Accounts	1,167	950
Bond Charge Collection and Bond Charge Payment Accounts	549	514
Recoverable costs, current portion	610	613
Interest receivable	41	33
Other assets	91	75
Total current assets	2,458	2,185
Total assets	$ 10,503	$ 10,915
Capitalization and Liabilities		
Capitalization:		
Net assets	$ -	$ -
Long-term debt:		
Revenue bonds	9,508	9,995
Total capitalization	9,508	9,995
Current liabilities:		
Current portion of long-term debt	487	470
Accounts payable	453	394
Accrued interest payable	55	56
Total current liabilities	995	920
Commitments and Contingencies (Note 7)		
Total capitalization and liabilities	$ 10,503	$ 10,915

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, 2007 and 2006 (in millions)

	2007	2006
Operating revenues:		
Power charges	$ 4,433	$ 3,890
Surplus sales	410	480
Total operating revenues	4,843	4,370
Operating expenses:		
Power purchases	4,732	5,038
Energy settlements	(47)	(288)
Other expenses	30	33
Recovery (deferral) of recoverable operating costs	128	(413)
Total operating expenses	4,843	4,370
Income from operations	-	-
Bond charges	855	842
Interest income	167	130
Interest expense	(424)	(432)
Recovery of recoverable debt service and related costs	(598)	(540)
Net increase in net assets	-	-
Net assets, beginning of year	-	-
Net assets, end of year	$ -	$ -

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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, 2007 and 2006 (in millions)

	2007	2006
Cash flows from operating activities:		
Receipts:		
Power charges	$ 4,439	$ 3,852
Surplus sales	397	498
Energy settlements	47	288
Payments for power purchases and other expenses	(4,719)	(5,097)
Net cash provided by (used in) operating activities	164	(459)
Cash flows from non-capital financing activities:		
Receipt of bond charges	865	823
Bond payments	(447)	(436)
Interest payments	(448)	(466)
Proceeds from issuance of revenue bonds	-	2,594
Cost of issuance net of underwriters discount	-	(25)
Defeasance of revenue bonds	-	(2,628)
Net cash used in non-capital financing activities	(30)	(138)
Cash flows from investing activities:		
Interest received on investments	159	123
Net cash provided by investing activities	159	123
Net increase (decrease) in cash and equivalents	293	(474)
Restricted cash and equivalents, beginning of year	2,365	2,839
Restricted cash and equivalents, end of year	$ 2,658	$ 2,365
Restricted cash and equivalents included in:		
Operating Reserve Account	$ 612	$ 591
Debt Service Reserve Account (a component of the total of $930 and $910 at June 30, 2007 and 2006, respectively)	330	310
Operating and Priority Contract Accounts	1,167	950
Bond Charge Collection and Bond Charge Payment Accounts	549	514
Restricted cash and equivalents, end of year	$ 2,658	$ 2,365
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Income from operations	$ -	$ -
Changes in net assets and liabilities to reconcile operating income to cash net provided by (used in) operations:		
Recoverable costs	223	(429)
Accounts payable	(59)	(30)
Total adjustments	164	(459)
Net cash provided by (used in) operating activities	$ 164	$ (459)

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 (CPUC).

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

2. Summary of Significant Accounting Policies

Basis of Presentation

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

The financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the business-type activities and major funds of the State of California that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position of the State of California as of June 30, 2007 and 2006, and the changes in its financial position and its cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Restricted Cash 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 (PMIA). Generally, the investments in PMIA are available for withdrawal on demand. The PMIA cash and investments are recorded at amortized cost, which approximates market. 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 (FPA). The GICs are carried at cost and the U.S. government backed agency security is carried at amortized cost.

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

Option agreements are reported at fair value and are included in other assets on the statement of net assets. At June 30, 2007 and 2006 those amounts were $52 million and $43 million respectively. Fair value is determined based on market quotes for those or similar instruments on active exchanges. Realized and unrealized gains and losses on such contracts are reflected as changes to fuel operating costs which are included in power purchases in the statement of revenues, expenses and changes in net assets.

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

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

The brokerage firm that facilitates certain of the Fund's hedging contracts requires that the Fund maintain a security deposit, which is invested in compliance with the California Government Code. These funds are invested in money market mutual funds and government bonds and are carried at fair value. The investment in money market mutual funds amounted to $23 million and $5 million at June 30, 2007 and 2006, respectively, and the investments in treasury bills and government bonds amounted to $16 million at June 30, 2007 and 2006 all of which are included in other assets on the statement of net assets.

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

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

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

customers. Costs are recovered over the life of the bonds (2022) as determined by DWR's revenue requirement process.

Surplus sales represent DWR's 1) allocated portion of the IOUs total surplus energy sales and 2) the sale of gas not needed for the generation of power. The revenue from the sale of excess energy by the IOUs is shared on a pro-rata basis between DWR and the IOUs, based on the amount of energy provided by DWR relative to the total amount of energy provided from IOU generation in the individual IOU's service territory.

3. Restricted Cash and Investments

The State of California has a deposit policy for custodial credit risk. As of June 30, 2007 and 2006, $24 million and $23 million, respectively, of the Fund's cash balances were uninsured and uncollateralized.

As of June 30, 2007 and 2006, the Fund had the following cash, cash equivalents and investments (in millions):

Investment	Maturity	2007	2006
State of California Pooled Money Investment Account - State Money Investment Fund	5.5 months average	$ 2,618	$ 2,323
Cash		40	42
Total cash and equivalents		2,658	2,365
Guaranteed investment contracts	May 1, 2022	500	500
Forward purchase agreement (FPA)	November 1, 2007	100	100
		$ 3,258	$ 2,965

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

Credit Risk: 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 subject to limits of no more than 10% of PMIA. The PMIA does not invest in leveraged products or inverse floating rate securities. The PMIA is not rated.

The Fund's investments in the guaranteed investment contracts and forward purchase agreement are rated as follows, by Standard & Poor's (S&P) and Moody's, respectively, at June 30, 2007 (in millions):

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

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

Interest on deposits in PMIA varies with the rate of return of the underlying portfolio and approximated 5.3% and 4.7% at June 30, 2007 and 2006, respectively. For the years ended June 30, 2007 and 2006, interest earned on the deposit in PMIA was $136 million and $98 million, respectively.

Interest on the GICs is paid semi-annually at interest rates ranging from 5.2% to 5.5%. Interest earned on the GICs was $26 million and $27 million for the years ended June 30, 2007 and 2006, respectively. The GICs mature in 2022.

The FPA allows the revenue bond trustee 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 each for the years ended June 30, 2007 and 2006.

4. Long-Term Debt

The following activity occurred in the long-term debt accounts during the years ended June 30, 2007 and 2006 (in millions):

	Revenue Bonds	Unamortized Premium	Deferred Loss on Defeasance	Total
Balance, June 30, 2005	$ 10,696	$ 286	$ -	$ 10,982
Refunding				
Issuance of debt	2,594	-	-	2,594
Defeasance of debt	(2,353)	(72)	(218)	(2,643)
Payments	(436)	-	-	(436)
Amortization	-	(40)	8	(32)
Balance, June 30, 2006	10,501	174	(210)	10,465
Payments	(447)			(447)
Amortization	-	(37)	14	(23)
Balance, June 30, 2007	10,054	137	(196)	9,995
Less current portion	470	31	(14)	487
	$ 9,584	$ 106	$ (182)	$ 9,508

The tax-exempt revenue bonds consist of the following at June 30, 2007 and 2006, respectively (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding 2007	Amount Outstanding 2006
A	3.125-6.0%	2022	2012	$ 3,274	$ 3,684
B	Variable	2020	Callable	1,000	1,000
C, D, F	Variable	2022	Callable	3,992	4,009
G	Variable	2018	Callable	1,788	1,808
				10,054	10,501
Plus unamortized bond premium				137	174
Less deferred loss on defeasance				(196)	(210)
Less current maturities				(487)	(470)
				$ 9,508	$ 9,995

In December 2005, DWR issued an aggregate $2.594 billion in variable rate refunding revenue bonds (Series F and G) to advance refund $2.353 billion of outstanding 2002 Series A fixed rate bonds.

The proceeds of the refunding bonds, along with funds released from the Bond Charge Payment Account ($42 million) and Debt Service Reserve Account ($17 million), were used to purchase securities that were deposited in an irrevocable trust with an escrow agent to provide for future debt service payments on the advance refunded bonds and pay for underwriting fees and other issuance costs. As a result, the advance refunded bonds are considered to be defeased and the related liabilities have been removed from the financial statements.

The refunding resulted in an accounting loss of approximately $218 million which has been deferred over the life of the refunded debt. However, the Fund effectively reduced its aggregate debt service payments by approximately $278 million through 2022 and achieved an economic gain (difference between the present values of the old and new debt service payments) estimated at the date of bond issuance to be $145 million. The actual economic gain will be dependent on basis risk associated with the interest rate swaps described in the following paragraph.

The total amount of bonds refunded in advance and still outstanding was $2.353 billion at June 30, 2007. These bonds cannot be called until 2012.

Series B, C, F and G are variable rate bonds and have either daily or weekly rate reset modes, and Series D has 35-day auction periods. The variable rate bonds have a final stated maturity of 2022, but will be retired in sinking fund installments from 2008 to 2022. The interest rates for the variable debt for the year ended June 30, 2007 and 2006, ranged from 2.9% to 4.1% and from 1.5% to 4.0%, respectively.

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.

The payment of principal and interest for all Series B bonds, $1.73 billion of Series C bonds, all Series F bonds and $90 million of Series G 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. There are no outstanding amounts on the letters of credit at June 30, 2007. The Fund pays fees of 0.45% per annum on the stated amount of the letters of credit for the Series B and C bonds, and range from 0.35% to 0.38% per annum on the stated amount for the Series F and G bonds. The Series B and C letters of credit expire in fiscal 2011, while the Series F and G letters of credit expire between fiscal years 2009 and 2011.

The remaining $1 billion Series C bonds and $1.7 billion Series G bonds are credit enhanced by bond insurance for the timely payment of principal and interest. Liquidity support for these variable rate bonds is provided by bank liquidity facilities. Any funds paid under the bond insurance facilities are immediately due and payable by the Fund. Bonds purchased under the initial liquidity facilities are required to be redeemed in equal installments over a five or seven year period beginning six months after the termination date of the liquidity facilities. There are no outstanding amounts due under liquidity facilities at June 30, 2007. Three liquidity facilities backing $400 million in Series C bonds expire in fiscal year 2011, and two liquidity facilities underlying $600 million of Series C bonds expire in fiscal year 2012. The Fund pays fees of 0.22% to 0.28% per annum under the Series C liquidity facilities. The Series G bonds have liquidity facilities that expire at various future dates. Four liquidity facilities backing $450 million in Series G bonds expire in fiscal year 2009, five liquidity facilities backing $648 million expire in fiscal year 2011, two liquidity facilities underlying $300 million expire in fiscal year 2013 and the remaining liquidity facility backing $300 million in Series G bonds expires in

fiscal year 2016. The Fund pays fees of 0.15% to 0.19% per annum under the Series G liquidity facilities

Future payment requirements on the revenue bonds are as follows at June 30, 2007 (in millions):

Fiscal Year	Principal	Interest [1]	Total
2008	$ 470	$ 417	$ 887
2009	493	395	888
2010	518	371	889
2011	545	347	892
2012	573	321	894
2013-2017	3,330	1,165	4,495
2018-2022	4,125	449	4,574
	$ 10,054	$ 3,465	$ 13,519

[1] Variable portion of interest cost calculated using the June 30, 2007 Bond Market Association Municipal Swap Index (BMA).

5. Interest Rate Swaps

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

The terms, fair values, and credit ratings of counterparties for the various swap agreements at June 30, 2007 are summarized in the following table (in millions):

Outstanding Notional Amount	Fixed Rate Paid by Fund	Variable Rate [1] Received by Fund	Fair Value	Swap Termination Date	Counterparty Credit Rating S&P	Moody's	Fitch
$ 94	2.914%	67% of LIBOR	$ 2	May 1, 2011	AAA	Aaa	AAA
234	3.024%	67% of LIBOR	6	May 1, 2012	AAA	Aaa	AAA
190	3.405%	BMA	1	May 1, 2013	AA	Aaa	AA-
95	3.405%	BMA	1	May 1, 2013	A+	Aa3	AA-
28	3.405%	BMA	-	May 1, 2013	AA-	Aa3	AA-
194	3.204%	67% of LIBOR	5	May 1, 2014	AA+	Aaa	AA
308	3.184%	66.5% of LIBOR	7	May 1, 2015	A+	Aa3	AA-
174	3.280%	67% of LIBOR	5	May 1, 2015	AAA	Aaa	AAA
202	3.342%	67% of LIBOR	6	May 1, 2016	AA+	Aa1	AA
485	3.228%	66.5% of LIBOR	16	May 1, 2016	AA+	Aa1	AA
202	3.389%	67% of LIBOR	6	May 1, 2017	A+	Aa3	AA-
480	3.282%	66.5% of LIBOR	17	May 1, 2017	AA	Aa1	AA-
515	3.331%	66.5% of LIBOR	19	May 1, 2018	AA-	Aa1	AA-
306	3.256%	64% of LIBOR	12	May 1, 2020	AA-	Aa1	AA-
453	3.325%	64% of LIBOR	19	May 1, 2022	AA-	Aaa	AA
$ 3,960			$ 122				

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

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

As of June 30, 2007, the variable rates on DWR's hedged bonds ranged from 2.92% to 4.05%, while 64%, 66.5% and 67% of LIBOR received on the swaps was equal to 3.40%, 3.54%, and 3.56% respectively.

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

Basis Risk: The Fund is exposed to basis risk on the swaps that have payments calculated on the basis of a percentage of LIBOR (a taxable rate index). The basis risk results from the fact that DWR's floating interest payments payable on the underlying debt are determined in the tax-exempt market, while DWR's floating receipts on the swaps are based on LIBOR, which is determined in the taxable market. When the relationship between LIBOR and the tax-exempt market change and move to convergence, or DWR's bonds trade at levels higher in rate in relation to the tax-exempt market, DWR's all-in costs would increase.

Effective July 1, 2006, DWR entered into the following basis swaps to mitigate this risk and optimize debt service by changing the variable rate received by the Fund to a 5 year Constant Maturity Swap Index (CMS). The fair values (in millions) were provided by the counterparties, using the par value, or marked-to-market, method.

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

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

2 Five year Constant Maturity Swap

As of June 30, 2007, 67% of LIBOR paid on the basis swaps was equal to 3.56% while the variable rates received based on the 5 year CMS Index varied from 3.45 to 3.47%.

Net amounts received (paid) under all swaps amounted to $11 million and $(9) million for the years ended June 30, 2007 and 2006, respectively.

Credit Risk: DWR has a total of twenty swap agreements with ten different counterparties. Approximately 22 percent of the swaps total notional value is with one counterparty with a credit rating of AA+/Aa1/AA. Of the remaining swaps, two are held with a single counterparty, approximating 20 percent of the outstanding notional value. That counterparty has credit ratings of AA-/Aa1/AA-. The remaining swaps are with separate counterparties, all having A+/Aa3/A+ ratings or better.

Termination Risk: DWR's swap agreements do not contain any out-of-the-ordinary termination provisions that would expose it to significant termination risk. In keeping with market standards, DWR or the counterparty may terminate a swap agreement if the other party fails to perform under the terms of the contract. In addition, the swap documents allow either party to terminate in the event of a significant loss of creditworthiness by the other party. DWR views the possibility of such events to be remote at this time. If a termination were to occur, at the time of the termination, DWR 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. In addition, a termination would mean that DWR's underlying floating rate bonds would no longer be hedged, and DWR would be exposed to floating rate risk, unless it entered into a new hedge following termination.

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

Swap Payments and Associated Debt: As rates vary, variable-rate bond interest payments and net swap interest payments will vary. As of June 30, 2007, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same, for their term were as follows (in millions):

	Variable Rate Bonds		Interest Rate	
Fiscal Year	**Principal**	**Interest**	**Swaps, Net**	**Total**
2008	$ 21	$ 148	$ (10)	$ 159
2009	127	146	(9)	264
2010	80	142	(9)	213
2011	241	138	(9)	370
2012	258	129	(7)	380
2013-2017	1,959	508	(26)	2,441
2018-2022	1,274	118	(4)	1,388
	$ 3,960	$ 1,329	$ (74)	$ 5,215

6. Retirement Plan and Postretirement Benefits

Plan Description

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

50 with five or more years of service are entitled to a retirement benefit, payable monthly for the remainder of their lives. Several survivor benefit options which reduce a retiree's unmodified benefit are available. Benefit provisions and all other requirements are established by state statute.

Annual Pension Cost
For the years ended June 30, 2007 and 2006, DWR's annual pension cost payable from the Fund and actual contribution allocated to the Fund based on the Fund's payroll costs approximated $1 million per year.

GASB 45
Effective not later than the year ending June 30, 2008, the Fund will be required to implement Governmental Accounting Standards Board Statement No. 45***,*** *Accounting and Financial Reporting by Employers for Post-Employment Benefits Other Than Pensions* (known as OPEBs). The State of California offers postretirement medical and dental benefits, which are currently accounted for on a pay-as-you-go basis. GASB 45 establishes standards for the measurement, recognition, display and disclosure of OPEB expense/expenditures and related liabilities (assets). Upon implementation of GASB 45, the State will be required to record an annual OPEB cost based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize unfunded actuarial liabilities over a period not to exceed thirty years.

The State has estimated that the unfunded liability of postretirement benefits approximates $48 billion. The amount that is allocable to the Fund is not expected to be material.

7. Commitments and Contingencies

Litigation and Regulatory Proceedings
DWR is involved in lawsuits and regulatory proceedings that could impact power costs and future revenue requirements.

In July, 2001, the Federal Energy Regulatory Commission (FERC) initiated a proceeding to calculate refunds for inflated prices in the California Independent System Operator (CAISO) and California Power Exchange Corporation markets through June 20, 2001. Because on a marketwide basis DWR is expected to be a net refund recipient in the FERC proceeding, this order poses no potential financial liability to DWR but in effect could reduce the award of refunds to DWR. DWR, along with other state agencies and the IOU's, is engaged in litigation at FERC and in the 9th Circuit Court of Appeal with the goal of increasing the refund amount and reversing FERC's orders which reduce the refunds awarded. It is not expected that DWR will be ordered to pay more in refunds than it receives on a marketwide basis. In addition, the Ninth Circuit Court of Appeals has ruled that FERC cannot require governmental entities such as DWR to pay refunds. Accordingly, DWR has two possible methods of increasing refunds to the State and eliminating reductions to the refund award: (1) successfully challenge on appeal FERC's ruling that DWR is required to pay refunds on its "sales" to the ISO; and (2) assert immunity based on FERC's lack of legal authority to order DWR to pay refunds. In the unlikely event that the Fund would be required to pay any refunds as a result of this proceeding, the refunds would be recoverable from ratepayers through future revenue requirements.

In February 2001, the State commandeered block forward contracts between the California Power Exchange and six suppliers. DWR paid approximately $352 million for energy provided under the contracts, which expired in December 2001. Certain market participants claimed they were entitled to damages in excess of $1 billion, their estimation of the fair value of the block forward contracts at the time of commandeering. In March 2007, the principal plaintiff, the California Power Exchange,

dismissed its action against the State. Another plaintiff dismissed its claim in May 2007, leaving one plaintiff whose claim is not material. Should the State be found liable for the remaining claim, and the Fund determined to be the source of moneys to pay damages, those damages would be recoverable from ratepayers through future DWR revenue requirements.

Management believes it is unlikely that DWR will ultimately have a net obligation in connection with the actions described above. As such, no liability has been recorded. Because of the early stage of the legal and regulatory proceedings, the ultimate outcome of these matters cannot be presently determined.

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 twelve years. Payments under these contracts approximated $4.7 billion and $4.9 billion for fiscal 2007 and 2006, respectively.

The remaining amounts of fixed obligations under the contracts as of June 30, 2007, are as follows (in millions):

Fiscal Year	Fixed Obligation
2008	$ 2,378
2009	2,238
2010	1,805
2011	1,070
2012	460
Thereafter	108
	$ 8,059

In addition to the fixed costs there are variable costs under several of the contracts. Management projected as of June 30, 2007 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $16 billion. The difference between the fixed costs and the expected total costs of the contracts are primarily due to the variable factors associated with dispatchable contracts and the cost of natural gas. The fund enters into forward gas futures contracts to hedge the cost of natural gas.

All of the power purchase contracts and gas purchase contracts are considered derivatives under the provisions of Governmental Accounting Standards Board Technical Bulletin 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets* (GASB TB 03-1). However, most of the power purchase contracts qualify as normal purchases under GASB TB 03-1 and as a result, market valuation and certain risk information are not required to be disclosed.

However, six power purchase contracts do not qualify as normal purchases and normal sales under the provisions of GASB TB 03-1 primarily resulting from either pricing terms that contain variables which are not clearly and closely related to the base energy price or the seller is not a generator of electricity. As a result, certain information regarding these power purchase contracts is required to be disclosed. The fair value of these six contracts at June 30, 2007 and 2006 approximated $(251)

million and $(353) million, respectively, using forward market prices discounted at DWR's internal cost of capital. These contracts, with a total capacity of 2,385 MWh, expire at various times, from December 2010 through December 2011.

DWR also has entered into transactions to hedge the price of natural gas through bilateral arrangements. These contracts are considered derivatives and do not scope out as normal purchases or normal sales under GASB TB 03-1. The fair value of the various transactions at June 30, 2007 and 2006 approximated $42 million and $(1) million, respectively, using forward market prices. These transaction volumes vary in size from 2,500 to 25,000 mmBtu per day, and they expire at various times from August 2007 through December 2011.

8. Energy Settlements

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

Energy settlements in 2007 total $47 million. DWR received $23 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 at such time as there is a distribution of monies. The Fund received an additional $24 million in other settlements, including $18 million from BP Energy Company.

Energy settlements in 2006 total $288 million. First, as part of the energy settlement with Mirant Corporation in 2005, DWR received unsecured claims totaling $90 million plus accrued interest in the Mirant Corporation bankruptcy case. In December 2005, DWR sold its claims and received $96 million. Second, the energy settlement with Enron Corp. became effective and DWR received $53 million. In addition, an energy settlement with Reliant Energy became effective in December 2005 and $66 million was received in March 2006. Finally, in May, 2006, DWR received $73 million from an arbitration agreement with Sempra Energy Resources.

Future revenues under the Mirant Corporation, Reliant Energy, Dynegy Inc, and Duke Energy Corporation settlements are subject to conditions outlined in the underlying settlement and allocation agreements.

9. Related Party Transactions

The California State Teachers' Retirement System (STRS) and The California Public Employees' Retirement System (CalPERS), which are part of the California state government, participate in the Fund's letters of credit with two financial institutions. The total commitment for two letters of credit underlying the STRS' participation approximates $177 million and expires on October 30, 2010. The total commitment for the letter of credit underlying the CalPERS' participation approximates $75 million and expires on December 1, 2008. There are no outstanding amounts on the letters of credit at June 30, 2007 or 2006.

APPENDIX B

BOOK-ENTRY SYSTEM

The information in this Appendix concerning The Depository Trust Company, New York, New York ("DTC") and DTC's book-entry system has been obtained from sources that DWR, the Underwriters and the Trustees believe to be reliable, but DWR, the Underwriters and the Trustees take no responsibility for the accuracy thereof.

DTC will act as securities depository for the Series 2008K Bonds. The Series 2008K Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Series 2008K Bond certificate will be issued for each interest rate borne by Series 2008K Bonds, each in the aggregate principal amount of Series 2008K Bonds applicable to such interest rate, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Series 2008K Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2008K Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 2008K Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2008K Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2008K Bonds, except in the event that use of the book-entry system for the Series 2008K Bonds is discontinued.

To facilitate subsequent transfers, all Series 2008K Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Series 2008K Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2008K Bonds. DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2008K Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. DWR will not have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Series 2008K Bonds. Beneficial Owners of Series 2008K Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2008K Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Series 2008K Bond documents. For example, Beneficial

Owners of Series 2008K Bonds may wish to ascertain that the nominee holding the Series 2008K Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Series 2008K Bonds unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Series 2008K Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Series 2008K Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State Treasurer or other Paying Agent, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, Agent, or the State Treasurer or other Paying Agent, subject to any statutory, or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the State Treasurer or other Paying Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Series 2008K Bonds at any time by giving reasonable notice to DWR or the Trustees. Under such circumstances, in the event that a successor depository is not obtained, Series 2008K Bond certificates are required to be printed and delivered.

DWR and the Trustees may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Series 2008K Bond certificates will be printed and delivered.

THE TRUSTEES, AS LONG AS A BOOK-ENTRY ONLY SYSTEM IS USED FOR THE SERIES 2008K BONDS, WILL SEND ANY NOTICES TO OWNERS ONLY TO DTC. ANY FAILURE OF DTC TO ADVISE ANY PARTICIPANT, OR OF ANY PARTICIPANT TO NOTIFY ANY BENEFICIAL OWNER, OF ANY NOTICE AND ITS CONTENT OR EFFECT WILL NOT AFFECT THE VALIDITY OR SUFFICIENCY OF ANY ACTION PREMISED ON SUCH NOTICE.

DWR and the Trustees cannot and do not give any assurances that DTC will distribute to Participants, or that Participants or others will distribute to the Beneficial Owners, payments of principal of and interest and premium, if any, on the Bonds paid or any redemption or other notices or that they will do so on a timely basis or will serve and act in the manner described in this Official Statement. Neither DWR nor the Trustees are responsible or liable for the failure of DTC or any Direct Participant or Indirect Participant to make any payments or give any notice to a Beneficial Owner with respect to the Series 2008K Bonds or any error or delay relating thereto.

The foregoing description of the procedures and record keeping with respect to beneficial ownership interests in the Series 2008K Bonds, payment of principal of and interest and other payments with respect to the Series 200C Bonds to Direct Participants, Indirect Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interest in such Bonds and other related transactions by and between DTC, the Direct Participants, the Indirect Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the Direct Participants, the Indirect Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters but should instead confirm the same with DTC or the Participants, as the case may be.

SO LONG AS CEDE & CO. IS THE REGISTERED OWNER OF THE SERIES 2008K BONDS, AS NOMINEE OF DTC, REFERENCES HEREIN TO THE HOLDERS SHALL MEAN CEDE & CO., AS AFORESAID, AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE SERIES 2008K BONDS.

APPENDIX C

SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE

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SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE

The following is a summary of certain provisions of the Indenture. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Indenture, copies of which are on file with the Trustee and Co-Trustee.

Definitions

For purposes of this Summary, capitalized terms shall have the meanings assigned to them below, or in other cases as contained elsewhere in this Official Statement as indicated in Appendix G.

"**Accreted Value**" means, with respect to any Capital Appreciation Bonds, (i) as of any Valuation Date, the amount set forth for such date in the Supplemental Indenture authorizing such Capital Appreciation Bonds and (ii) as of any date other than a Valuation Date, the sum of (a) the Accreted Value on the preceding Valuation Date and (b) the product of (1) a fraction, the numerator of which is the number of days having elapsed from the preceding Valuation Date and the denominator of which is the number of days from such preceding Valuation Date to the next succeeding Valuation Date, and (2) the difference between the Accreted Values for such Valuation Dates. Accreted Value shall be computed on a 30/360–day basis.

"**Act**" means Division 27 (commencing with Section 80000) of the State Water Code, as amended from time to time.

"**Additional Emergency Measures**" or "**Emergency Measures**" means Executive Order No. D-56-02 dated May 23, 2002, or any Proclamation or Order of the Governor of the State hereafter issued pursuant to the California Emergency Services Act (Chapter 7, Division 1, Title 2 of the California Government Code, as amended) (including, but not limited to, any regulations issued pursuant thereto) adopted in response to or in anticipation of the need to assure the availability of power to retail end-use customers in the State due to the inability or failure of an Electrical Corporation to purchase such power following the end of the Department's authority to enter into new Power Supply Contracts under Assembly Bill 1X.

"**Administrative Cost Account**" means the Account by that name established under the Indenture.

"**Aggregate Debt Service**" means, for any period and as of any date of calculation, the sum of the amounts of Debt Service for such period with respect to all Series of Bonds.

"**Alternate Debt Service Reserve Account Deposit**" means any irrevocable surety bond, insurance policy, letter of credit or any other similar obligation provided to the Trustee as a substitute for the deposit of cash and/or Authorized Investments, or another Alternate Debt Service Reserve Account Deposit, in the Debt Service Reserve Account.

"**Assembly Bill 1X**" means Chapter 4 of the Statutes of 2001 (AB 1 of the First Extraordinary Session) of the State, as amended from time to time, including, but not limited to, Chapter 9 of the Statutes of 2001 (SB 31 of the First Extraordinary Session).

"**Authorized Investments**" means and includes any of the following securities, if and to the extent the same are at the time legal for investment of the Department's funds pursuant to any law, and to the extent permitted under any applicable regulation, guideline and policy of the Department, as each is in effect from time to time:

(i) bonds or interest-bearing notes or obligations of the United States, or those for which the faith and credit of the United States are pledged for the payment of principal and interest;

(ii) bonds or interest-bearing notes or obligations that are guaranteed as to principal and interest by a federal agency of the United States;

(iii) bonds of the State or bonds for which the faith and credit of the State are pledged for the payment of principal and interest;

(iv) bonds or warrants, including, but not limited to, revenue warrants, of any county, city, metropolitan water district, California water district, California water storage district, irrigation district in the State, municipal utility district or school district of the State;

(v) bonds, consolidated bonds, collateral trust debentures, consolidated debentures or other obligations issued by general land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended, debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended, bonds or debentures of the Federal Home Loan Bank Board established under the Federal Home Loan Bank Act, stocks, bonds, debentures and other obligations of the Federal National Mortgage Association established under the National Housing Act, as amended, and the bonds of any federal home loan bank established under said act, obligations of the Federal Home Loan Mortgage Corporation, and bonds, notes and other obligations issued by the Tennessee Valley Authority under the Tennessee Valley Authority Act, as amended;

(vi) commercial paper rated within the top Rating Category by a Rating Agency and issued by corporations (1) organized and operating within the United States, (2) having total assets in excess of $500,000,000 and (3) approved by the Pooled Money Investment Board of the State, provided, however that eligible commercial paper may not exceed one hundred eighty (180) days' maturity, represent more than 10% of the outstanding paper of an issuing corporation nor exceed 30% of the resources of an investment program, and that at the request of the Department, such investment shall be secured by the issuer by depositing with the Trustee securities authorized by Section 53651 of the California Government Code of a market value of at least 10% in excess of the amount of the Department's investment;

(vii) bills of exchange or time drafts drawn on and accepted by a commercial bank the general obligations of which are rated within the top two Rating Categories by a Rating Agency, otherwise known as banker's acceptances, which are eligible for purchase by the Federal Reserve System;

(viii) negotiable certificates of deposit issued by a nationally or state-chartered bank or savings and loan association or by a state-licensed branch of a foreign bank which, to the extent they are not insured by federal deposit insurance, are issued by an institution the general obligations of which are rated in one of the top two Rating Categories by a Rating Agency;

(ix) bonds, debentures and notes issued by corporations organized and operating within the United States which securities are rated in one of the top two Rating Categories by a Rating Agency;

(x) interest-bearing accounts in state or national banks or in state or federal savings and loan associations having principal offices in the State, the deposits of which shall be secured at all times and in the same manner as state moneys are by law required to be secured;

(xi) deposits in the Surplus Money Investment Fund as referred to in the California Government Code;

(xii) repurchase agreements or reverse repurchase agreements, as such terms are defined in and pursuant to the terms of Section 16480.4 of the California Government Code;

(xiii) collateralized or uncollateralized investment agreements or other contractual arrangements with corporations, financial institutions or national associations within the United States, provided that the senior long-term debt of such corporations, institutions or associations is rated within the top two Rating Categories by a Rating Agency;

(xiv) money market funds that invest solely in obligations described in clause (i) of this definition; or

(xv) such other investments as may be authorized by a Supplemental Indenture, provided that each Rating Agency has confirmed in writing to the Trustee that the use of such additional investments will not, by itself, result in the withdrawal, suspension or downgrade of any rating issued by such Rating Agency with respect to any Outstanding Bonds.

"**Authorized Officer**" means the Director, any Deputy Director, the Chief, Division of Fiscal Services, the Deputy Controller and the Chief Counsel of the Department, and any other individual authorized by the Director to perform the act or sign the document in question.

"**Bank**" means any (i) bank or trust company organized under the laws of any state of the United States of America, (ii) national banking association, (iii) savings bank or savings and loan association chartered or organized under the laws of any state of the United States of America, or (iv) federal branch or agency pursuant to the International Banking Act of 1978 or any successor provisions of law, or domestic branch or agency of a foreign bank which branch or agency is duly licensed or authorized to do business under the laws of any state or territory of the United States of America.

"**Bond Charge**" has the same meaning as that term is defined in the 2002 Rate Agreement, including, without limitation, any Bond Charges imposed on power furnished by an Electric Service Provider (as defined in the 2002 Rate Agreement).

"**Bond Charge Collection Account**" means the account by that name established under the Indenture.

"**Bond Charge Payment Account**" means the account by that name established under the Indenture.

"**Bond Charge Revenues**" means Revenues received by the Department arising from Bond Charges.

"**Bond Related Costs**" has the same meaning as that term is defined in the 2002 Rate Agreement, and shall include the items of cost specified in section D.3 under the caption "Application and Flow of Funds" below.

"**Bonds**" means any obligations, issued in any form of debt, authorized by the Indenture and secured by a pledge of and lien on the Trust Estate on a parity with each other and with Parity Obligations, including, but not limited to, bonds, notes, bond anticipation notes, and commercial paper, but such term shall not include any Subordinated Indebtedness or Subordinated Obligations. "Bonds" may also include Interim Financing Notes as described under "Special Provisions Relating to Enhancement Facilities, Qualified Swaps, Other Similar Arrangements and Interim Financing Notes" below.

"Business Day" means (a) with respect to the Bonds, any day of the year other than (i) a Saturday or Sunday, (ii) a State legal holiday, (iii) any day which shall be in the city of Sacramento, California, or the city in which the Co-Trustee or relevant office of any Paying Agent, Registrar or Securities Depository or, if any Bond is supported by an Enhancement Facility, the provider of such Enhancement Facility is located, a legal holiday or a day on which Banks in any of such cities are required or authorized by law or other government action to close, or (b) with respect to any Series of Bonds, as may be provided by Supplemental Indenture.

"**Capital Appreciation Bonds**" means Bonds as to which interest is payable only at the maturity or prior redemption of such Bonds; *provided, however,* that if any such Bonds are converted to or from Bonds as to which interest is payable periodically, such Bonds shall be deemed to be Capital Appreciation Bonds only after or until such conversion, as the case may be. For the purposes of (i) receiving payment of the Redemption Price if a Capital Appreciation Bond is redeemed prior to maturity, or (ii) computing the principal amount of Bonds held by the Owner of a Capital Appreciation Bond in giving to the Department or the Trustee any notice, consent, request, or demand pursuant to the Indenture for any purpose whatsoever, the principal amount of a Capital Appreciation Bond on any date shall be deemed to be its Accreted Value as of such date.

"**Commercial Paper**" means Bonds issued as part of a program of short-term Bonds having the characteristics of commercial paper in that (i) such Bonds have a stated maturity not later than 270 days from their date of issue and (ii) maturing Bonds of such program may be paid with the proceeds of Bonds having the characteristics of Commercial Paper. Notwithstanding the foregoing, Commercial Paper may be paid with the proceeds of other Bonds.

"**Commission**" means the Public Utilities Commission of the State, or any successor to the rights, duties and obligations of the Commission under the Act.

"**Consultant**" means an accountant or firm of accountants (which may be the accountant or firm of accountants then serving as the auditor of the Department), or a management consultant or firm of management consultants, or an engineer or firm of engineers, which, in any case, shall be of recognized standing in the field of electric utility rate consulting, selected by the Department, and may be regularly retained to provide services to the Department but shall not be an officer or employee of the State.

"**Costs**" means costs, expenses and purposes for which Bonds may be issued under the Act, including, but not limited to, the following: (i) costs of Power and transmission, scheduling, and other related expenses incurred by the

Department, including, but not limited to, all amounts payable by the Department, of whatever kind and nature, under and pursuant to Power Supply Contracts and costs of avoiding purchasing Power for retail end-use customers paid or incurred pursuant to an Additional Emergency Measure; (ii) reimbursement of expenditures made from the Electric Power Fund for such purposes; (iii) repayment to the General Fund of the State of appropriations made to the Electric Power Fund pursuant to Assembly Bill 1X or Senate Bill 7X, repayment to the General Fund of appropriations made to the Electric Power Fund after the effectiveness of Assembly Bill 1X for purposes of Division 27 of the State Water Code, and repayment of General Fund moneys expended by the Department pursuant to the 2001 Emergency Measures; (iv) costs of establishing or maintaining reserves required or permitted by the Indenture, including, but not limited to, debt service and operating reserves; (v) costs of issuing Bonds and Interim Financing Notes or costs incidental to their payment or security, including, but not limited to, fees, expenses, and costs payable, and reimbursements, under Enhancement Facilities and the Credit and Security Agreement; (vi) capitalized interest on Bonds; and (vii) payment of principal, interest, and redemption, tender or purchase price of any (a) Bonds issued by the Department for the payment of any Costs, (b) Bonds issued to refund other Bonds, or (c) any other bonds, notes, or other evidences of indebtedness issued by the Department for purposes of the Act, including the Interim Financing Notes. Notwithstanding the foregoing, Costs shall not include (1) depreciation or obsolescence charges or reserves therefor, (2) amortization of intangibles or other bookkeeping entries of a similar nature; or (3) any costs of the Department relating to a Separately Financed Program.

"**Co-Trustee**" means U.S. Bank National Association, and its successor or successors and any other Person which may at any time be substituted in its place pursuant to the Indenture.

"**Counsel's Opinion**" means an opinion signed by an attorney or firm of attorneys of nationally recognized standing in the field of law relating to municipal bonds selected by the Department.

"Credit and Security Agreement" means the Credit and Security Agreement, dated as of June 26, 2001, among the State acting through the Department, various lenders and Morgan Guaranty Trust Company of New York as agent for such lenders, pursuant to which the Interim Financing Notes were issued and are secured, as supplemented and amended from time to time.

"**Credit Facility Reimbursement Obligation**" has the meaning as defined under "Special Provisions Relating to Enhancement Facilities, Qualified Swaps, Other Similar Arrangements and Interim Financing Notes" below.

"**Debt Service**" means, for purposes of determining deposits to and balances required to be on deposit in the Bond Charge Payment Account, the Debt Service Reserve Requirement, and the additional Bonds test as provided in the Indenture, for any period and as of any date of calculation, with respect to any Outstanding Bonds, an amount equal to the sum of (i) interest accruing during such period on such Bonds, except to the extent that such interest is to be paid from deposits in the Bond Charge Payment Account made from the proceeds of Bonds or Subordinated Indebtedness, and (ii) that portion of each Principal Installment for such Bonds which would accrue during such period if such Principal Installment were deemed to accrue daily in equal amounts from the next preceding Principal Installment due date for such Bonds (or, if there shall be no such preceding Principal Installment due date or such preceding Principal Installment due date is more than one (1) year prior to the due date of such Principal Installment, then from a date one (1) year preceding the due date of such Principal Installment or from the date of issuance of such Bonds, whichever date is later). For purposes of such calculations, the following assumptions are to be used:

(i) such interest and Principal Installments shall be calculated on the assumptions that (a) no Bonds (except for Option Bonds actually tendered for payment and not purchased in lieu of redemption prior to the redemption date thereof) Outstanding at the date of calculation will cease to be Outstanding except by reason of the payment of each Principal Installment on the due date thereof and (b) the principal amount of Option Bonds tendered for payment shall be deemed to be payable on the date required to be paid pursuant to such tender;

(ii) if 20% or more of the principal of such Bonds is not due until the final stated maturity of such Bonds, principal and interest on such Bonds may, at the option of the Department, written notice of which shall be signed by an Authorized Officer and filed with the Trustee, be treated as if such principal and interest were due based upon an amortization of principal resulting in approximately level debt service (principal and interest) over the respective terms of such Bonds;

(iii) interest accruing on Variable Rate Bonds during any future period shall be assumed to accrue at a rate equal to the greater of (a) 130% of the highest average interest rate on such Variable Rate Bonds in any calendar month during the twelve (12) calendar months ending with the month preceding the date of calculation, or such shorter period that such Variable Rate Bonds shall have been Outstanding, or (b) 4.0%,

(iv) the principal of Bonds issued as Commercial Paper will be treated as if such principal were due based upon level amortization of principal from the date of calculation to the latest maturity date of any Bonds, and the interest on such Commercial Paper shall be calculated as if such Commercial Paper were Variable Rate Bonds;

(v) the principal and interest portions of the Accreted Value of Capital Appreciation Bonds becoming due at maturity or by virtue of a Sinking Fund Installment shall be included in the calculations of accrued and unpaid and accruing interest or Principal Installments in such manner and during such period of time as is specified in the Supplemental Resolution authorizing such Capital Appreciation Bonds;

(vi) notwithstanding paragraphs (iii) or (iv) above, if the Department, in connection with any Variable Rate Bonds or Commercial Paper, has entered into a Qualified Swap that provides that the Department is to pay to the counterparty an amount determined based upon a fixed rate of interest on such Outstanding principal amount of such Variable Rate Bonds or Commercial Paper, and that the counterparty is to pay to the Department an amount determined based upon a variable rate of interest on such Outstanding principal amount of such Variable Rate Bonds or Commercial Paper (a "variable rate payment") or the amount by which the rate at which such Variable Rate Bonds or Commercial Paper bear interest exceeds a stated rate of interest or, if the Department has entered into a Qualified Swap that provides that the Department is to pay to the counterparty one variable rate payment and that the counterparty is to pay to the Department a different variable rate payment, for so long as and to the extent that such Qualified Swap remains in full force and effect it shall be assumed that such Variable Rate Bonds and Commercial Paper bear interest at a rate equal to the sum of (A) the fixed rate of interest to be paid by the Department or the rate in excess of which the counterparty is to make payment to the Department in accordance with such Qualified Swap, and (B) the greater of (if positive) (1) the average difference between the actual interest rate paid by the Department on such Variable Rate Bonds or Commercial Paper and the variable interest rate the relevant counterparty paid to the Department, taking into account all variable rate payments, during the twelve (12) calendar months ending with the calendar month preceding the date of calculation, or such shorter period that such Variable Rate Bonds or Commercial Paper shall have been Outstanding, and (2) the difference between the actual interest rate paid by the Department on such Variable Rate Bonds or Commercial Paper and the variable interest rate received from the relevant counterparty, taking into account all variable rate payments, as calculated at the end of the calendar month preceding the date of calculation;

(vii) if the Department, in connection with any fixed rate Bonds, has entered into a Qualified Swap that provides that the Department is to pay to the counterparty an amount determined based upon a variable rate of interest on the Outstanding principal amount of such Bonds, it shall be assumed that such Bonds bear interest at the variable rate of interest to be paid by the Department, with interest on such Bonds calculated as if they were Variable Rate Bonds as described in paragraph (iii) above; *provided, however,* if the counterparty is to pay to the Department a fixed rate of interest on the amount of such Bonds that is less than the fixed rate payable thereon by the Department, it shall be assumed that such Bonds bear additional interest at the rate which is the difference between the fixed rates payable by and to the Department; and

(viii) principal and interest payments on Bonds shall be excluded to the extent such payments are to be paid from amounts then currently on deposit with the Trustee or other Fiduciary in escrow specifically therefor and restricted to Defeasance Securities.

"**Debt Service Reserve Account**" means the account by that name established under the Indenture.

"**Debt Service Reserve Requirement**" means, as of any date of calculation, an amount equal to Maximum Aggregate Annual Debt Service. In furtherance of the covenant described below under "Covenant Relating to Retirement of Bonds," for the purpose of calculating the Debt Service Reserve Requirement at the time of, and deposit to be made into the Debt Service Reserve Account in connection with, the issuance of the initial Series of Bonds (or more than one Series of Bonds delivered on the same date as the initial Series of Bonds) (collectively, the "initial Bonds"), Debt Service on the initial Bonds shall be calculated by assuming that the initial Bonds will mature in such amounts and at such times (with the initial Bonds assumed to bear interest as provided in the definition of Debt Service) as will result in substantially level debt service (to the extent contemplated by such covenant of the Department) on the initial Bonds, without regard to any additional Series of Bonds.

"**Defeasance Security**" means:

(i) cash;

(ii) an Authorized Investment specified in clause (i), (ii), (iii) or (v) of the definition thereof, which is not callable or redeemable at the option of the issuer thereof;

(iii) an Authorized Investment specified in clause (iv) of the definition thereof (a "Municipal Bond"), which Municipal Bond is fully secured as to principal and interest by an irrevocable pledge of moneys or direct and general obligations of, or obligations guaranteed by, the United States of America, which moneys or obligations are segregated in trust and pledged for the benefit of the holder of the Municipal Bond, and which Municipal Bond is rated in the highest Rating Category by at least two Rating Agencies and *provided, however,* that such Municipal Bond is accompanied by a Counsel's Opinion to the effect that such Municipal Bond is not subject to redemption prior to the date the proceeds of such Municipal Bond will be required for the purposes of the investment being made therein; or

(iv) any other investment designated in a Supplemental Indenture as a Defeasance Security for purposes of defeasing the Bonds authorized by such Supplemental Indenture, provided that each Rating Agency has confirmed in writing to the Trustee that the use of such other investment will not, by itself, result in the withdrawal, suspension or downgrade of any rating issued by such Rating Agency with respect to any such Bonds to be defeased.

"**Department**" means the State of California Department of Water Resources, existing pursuant to Article 1 (commencing with Section 120) of Chapter 2 of Division 1 of the California Water Code, or any successor to the rights, duties and obligations of the Department under the Act and the Indenture.

"**Direct Access Power Charge**" means any charge imposed by the Commission (by an order that is final and non-appealable) on, and received by the Department from, any Person receiving power from an Electric Service Provider intended to recover the Department's Revenue Requirements other than Bond Related Costs, and shall in no event include Bond Charges; *provided, however,* that Bond Charges may be separately imposed on such Persons.

"**Direct Access Power Charge Revenues**" means Revenues received by the Department arising from Direct Access Power Charges.

"**Direct-Pay Credit Facility**" means a Credit Facility issued in the form of a letter of credit and designated by the issuer thereof as a "Direct Pay Letter of Credit."

"**Director**" means the Director of Water Resources of the State, or any successor to the rights, duties and obligations of the Director under the Act and the Indenture.

"**Eighth Supplemental Indenture**" means the Eighth Supplemental Trust Indenture among the Department, the Trustee, and the Co-Trustee, relating to the Series 2008K Bonds

"**Electrical Corporation**" has the same meaning as that term is defined in Section 218 of the Public Utilities Code.

"**Electric Power Fund**" means the fund by that name established under the Indenture.

"**Electric Service Provider**" has the meaning given in the 2002 Rate Agreement.

"**Electronic Means**" means telecopy, facsimile transmission, e-mail transmission or other similar electronic means of communication.

"**Enabling Measures**" means, collectively, the Act and the Additional Emergency Measures, or any of them, as appropriate.

"**Enhancement Facility**" means any letter of credit, standby purchase agreement, line of credit, policy of bond insurance, surety bond, guarantee or similar instrument, or any other agreement, securing, providing liquidity for, supporting or enhancing Outstanding Bonds, or any combination of the foregoing, or any agreement relating to the reimbursement thereof whether or not such instrument or agreement has been drawn upon, obtained by the Department.

"**Events of Default**" means the events defined as such under caption "Events of Default and Remedies" below.

"**Excess Amounts**" has the meaning specified in section F under the caption "Application and Flow of Funds" below.

"**Fiduciary**" or "**Fiduciaries**" means the Trustee, the Co-Trustee, any Registrar, any Paying Agent, or any or all of them, as may be appropriate.

"**Financing Documents**" means any resolution, indenture (including the Indenture), trust agreement, loan agreement, revolving credit agreement, reimbursement agreement, standby purchase agreement or other agreement or instrument adopted or entered into by the Department authorizing, securing or enhancing any evidence of indebtedness issued pursuant to the Act, including the Bonds, Parity Obligations and Subordinated Indebtedness, as from time to time amended or supplemented in accordance therewith.

"**Fiscal Year**" means the twelve-month period commencing on July 1 of each year; *provided, however,* that the Department may at any time adopt a different twelve-month period as the Fiscal Year, in which case July 1, when used herein with reference to Fiscal Year, shall be construed to mean the first day of the first calendar month of such different Fiscal Year.

"**Indenture**" means the Trust Indenture among the Department, the Trustee and the Co-Trustee, as from time to time amended or supplemented by Supplemental Indentures.

"Interim Financing Notes" means, collectively, the Department's "Tax-Exempt Bonds" and "Taxable Bonds" issued and outstanding under the Credit and Security Agreement.

"**Maximum Aggregate Annual Debt Service**" means, as of any date of calculation, an amount equal to the maximum Aggregate Debt Service coming due on Bonds then Outstanding in any calendar year thereafter, commencing with the then current calendar year, excluding interest to be paid from the proceeds of Bonds or Subordinated Indebtedness and on deposit in the Bond Charge Payment Account.

"**Minimum Operating Expense Available Balance**" means, at the time Revenue Requirements are submitted to the Commission pursuant to the Indenture, (i) for so long as the Department is procuring all or a portion of the Residual Net Short, $1 billion, and (ii) thereafter, the maximum amount projected by the Department by which Operating Expenses exceed Power Charge Revenues during any one calendar month during that Revenue Requirement Period. Such projections shall be based on such assumptions as the Department deems to be appropriate after consultation with the Commission and may take into account a range of possible future outcomes.

"**Operating Account**" means the account by that name established under the Indenture.

"**Operating Expenses**" means the following costs and expenses of the Department in connection with its activities as permitted under the Enabling Measures: (i) payments for the purchase of Power and the delivery of such Power including, but not limited to, amounts paid under short-term Power Supply Contracts, Priority Long Term Power Contracts and other long-term Power Supply Contracts, termination and liquidation damage payments thereunder, payments thereunder relating to emission costs and emission opportunity costs, amounts payable in respect of balance of month-ahead Power, hour-ahead Power and real time balancing Power, including in-market and out-of-market purchases, costs of transmission, distribution, scheduling, dispatch and other expenses of the Department in connection with the delivery of its Power, and costs of avoiding purchasing Power for retail end-use incurred pursuant to an Additional Emergency Measure; (ii) payments for or in connection with fuel to be used in the production of Power purchased by the Department, whether paid as a charge under a Power Supply Contract or a separate agreement for the purchase, transportation or storage of fuel for use in the generation of Power, including, but not limited to, termination and liquidated damage payments under fuel purchase agreements, payments under options or other fuel or electricity instruments, and payments under financial instruments relating to fuel costs or costs related to fuel costs; (iii) payments under any security agreements executed in connection with Power Supply Contracts or in connection with agreements for the purchase, transportation and storage of fuel, or any other agreement, relating to the purchase of Power; (iv) reasonable administrative, general and overhead expenses and payments for employee benefits, including, but not limited to, payments to savings, pension, retirement, health and hospitalization funds; (v) insurance premiums including, but not limited to, bond and Qualified Swap insurance premiums; (vi) legal and engineering expenses; (vii) expenses for consulting and technical services; (viii) charges paid by the Department pursuant to any licenses, orders or

mandates from any agency or regulatory body having lawful jurisdiction; (ix) any taxes, governmental charges, and any other similar costs and expenses required to be paid by the Department, and costs required by the California Independent System Operator to be paid by the Department or imposed on the Department by regulatory or other governmental requirements; (x) costs of complying with any arbitrage restrictions or rebate requirements relating to the Bonds under Section 148 of the Internal Revenue Code of 1986 as amended, or a successor statute, and applicable regulations thereunder; (xi) such other costs and expenses as may be provided for in a Rate Agreement as being recoverable as part of Revenue Requirements; and (xii) such other costs and expenses with respect to the sale of Power to local publicly owned electric utilities, as defined in Assembly Bill 1X, or in connection with the exchange of Power or the sale, transfer or other disposition of Power not required for use within the State as permitted by the Act, which would constitute current operating expenses under generally accepted accounting principles or statutory accounting principles as in effect from time to time and applicable to governmental units such as the Department. Notwithstanding the foregoing, Operating Expenses shall not include (a) any repayments to the General Fund of the State of advances made to the Department from amounts appropriated to the Electric Power Fund or interest thereon payable at the Pooled Money Investment Rate; (b) principal, Redemption Price and Purchase Price of and interest on Bonds; (c) debt service on or payments under Parity Obligations, Subordinated Indebtedness or Subordinated Obligations; (d) principal of and interest on the Interim Financing Notes and other payments required to be made by the Department under the Credit and Security Agreement; (e) depreciation or obsolescence charges or reserves therefor; (f) amortization of intangibles or other bookkeeping entries of a similar nature; (g) any amounts paid from Bond Charge Revenues pursuant to section D.1 under the caption "Application and Flow of Funds" below; or (h) any costs and expenses attributable to a Separately Financed Program.

"**Operating Reserve Account**" means the account by that name established under the Indenture.

"**Operating Reserve Account Requirement**" or "**Minimum Operating Reserve Account Requirement**" means, during each Revenue Requirement Period, the greater of (i) the largest aggregate amount projected by the Department by which Operating Expenses exceed Power Charge Revenues during any consecutive seven (7) calendar months commencing in such Revenue Requirement Period, and (ii) either (A) 18% of the Department's projected annual Operating Expenses for any Revenue Requirement Period in which the Department is procuring all or a portion of the Residual Net Short and which commences prior to 2006, or (B) 12% of the Department's projected annual Operating Expenses for any Revenue Requirement Period in which the Department is not procuring all or a portion of the Residual Net Short or which commences after 2005; *provided, however,* that solely for purposes of (A) and (B) above for Revenue Requirement Periods commencing after 2003, the projected amount shall not be less than the applicable percentage of the Department's Operating Expenses for the most recent twelve (12) calendar month period for which the Department determines that reasonably full and complete Operating Expense information is available, adjusted as described in the next sentence. If the Department was financially responsible and liable under a Power Supply Contract during all or a portion of the applicable twelve (12) calendar month period, but financial responsibility has been assumed by another Person and the Department has been entirely relieved of financial liability and all other liabilities under the contract, or the contract has terminated or will terminate by its terms prior to the end of the Revenue Requirement Period for which the Operating Reserve Account Requirement is being calculated, then the relevant costs associated with that contract shall be excluded from the calculation of the historical Operating Expenses. If amended Revenue Requirements are filed with the Commission during any Revenue Requirement Period, the Operating Reserve Account Requirement shall be recalculated for the remainder of such Revenue Requirement Period as provided above. Notwithstanding the foregoing, in connection with the determination of whether additional Bonds may be issued upon compliance with the Indenture, the relevant calculation under clause (i) above shall be made in respect of a consecutive seven (7) calendar month period in the test period specified by the applicable provision of the Indenture. All projections referenced in this paragraph shall be based on such assumptions as the Department deems to be appropriate after consultation with the Commission and, in the case of clause (i) above, may take into account a range of possible future outcomes. The Operating Reserve Account Requirement shall include, but shall not be limited to, the Priority Contract Contingency Reserve Amount.

"**Option Bonds**" means Bonds which by their terms may be tendered by and at the option of the Owner thereof to the Department or to the issuer of an Enhancement Facility providing liquidity with respect to such Bonds, for purchase prior to the stated maturity thereof, or the maturities of which may be extended by and at the option of the Owner thereof.

"**Outstanding**," when used with reference to Bonds or Bonds of a Series, means, as of any date, Bonds or Bonds of such Series theretofore or thereupon being delivered under the Indenture except:

(i) Any Bonds canceled at or prior to such date;

(ii) Bonds the principal and Redemption Price, if any, of and interest on which have been paid in accordance with the terms thereof;

(iii) Bonds in lieu of or in substitution for which other Bonds shall have been delivered pursuant to the Indenture;

(iv) Bonds deemed to have been paid as provided in the Indenture;

(v) Option Bonds tendered or deemed tendered in accordance with the provisions of the Supplemental Indenture authorizing such Bonds on the applicable tender date, if the purchase price thereof and interest thereon shall have been paid or amounts are available and set aside for such payment as provided in such Supplemental Indenture, except to the extent such tendered Option Bonds are held by the Department or an issuer of an Enhancement Facility and/or thereafter may be resold pursuant to the terms thereof and of such Supplemental Indenture; and

(vi) as may be provided with respect to such Bonds by the Supplemental Indenture authorizing such Bonds;

and, for purposes of certain provisions of the Indenture (see "Special Provisions Relating to Enhancement Facilities, Qualified Swaps, Other Similar Arrangements and Interim Financing Notes"), means any outstanding Interim Financing Notes.

"**Owner**" or any similar term means the registered owner of any Bond as shown on the books for the registration and transfer of Bonds maintained in accordance with the Indenture and, for the purposes of certain provisions of the Indenture (see "Special Provisions Relating to Enhancement Facilities, Qualified Swaps, Other Similar Arrangements and Interim Financing Notes"), means the holder of any Interim Financing Note.

"**Parity Obligations**" means Reimbursement Obligations and amounts payable under Qualified Swaps. For purposes of certain provisions of the Indenture, any Parity Obligations entered into or issued subsequent to the date of delivery of this Indenture shall specify, to the extent applicable, the interest and principal components of, or the scheduled payments corresponding to interest under, such Parity Obligations. Parity Obligations shall comply with the second paragraph under "Events of Default and Remedies" below.

"**Paying Agent**" means any paying agent for the Bonds of any Series and its successor or successors and any other Person which may at any time be substituted in its place pursuant to the Indenture.

"**Person**" means any individual, corporation, firm, partnership, joint venture, association, joint-stock company, trust, unincorporated association, limited liability company or partnership, or other legal entity or group of entities, including, but not limited to, a governmental entity or any agency or subdivision thereof.

"**Pooled Money Investment Rate**" means, for any amounts deposited in the Electric Power Fund from the General Fund and for any period, the rate of interest to be paid on such amounts to the State's Pooled Money Investment Account as determined from time to time for such period.

"**Power**" means electric power and energy, including, but not limited to, capacity and output, or any of them.

"**Power Charge Revenues**" means Revenues received by the Department arising from Power Charges.

"**Power Charges**" has the same meaning as that term is defined in the 2002 Rate Agreement.

"**Power Supply Contract**" means any contract or agreement entered into by the Department pursuant to the Enabling Measures and under which the Department purchases Power, or purchases fuel for conversion to or in exchange for Power, or any option with respect thereto.

"**Principal Installment**" means, as of any date of calculation and with respect to any Series so long as any Bonds thereof are Outstanding, (i) the principal amount of Bonds (including the principal amount of any Option Bonds tendered for payment and not purchased) of such Series due (or so tendered for payment and not purchased) on any date for which no Sinking Fund Installments have been established, or (ii) the unsatisfied balance (determined as provided in section D.4 under

the caption "Application and Flow of Funds" below) of any Sinking Fund Installments due on any date for Bonds of such Series, plus the amount of the sinking fund redemption premiums, if any, which would be applicable upon redemption of such Bonds on such date in a principal amount equal to said unsatisfied balance of such Sinking Fund Installments, or (iii) if both clause (i) and clause (ii) apply on the same date with respect to different Bonds of such Series, the sum of such principal amount of Bonds and of such unsatisfied balance of Sinking Fund Installments due on such date plus such applicable redemption premiums, if any.

"**Principal Payment Date**" means any date upon which the principal amount of Bonds of a Series is due hereunder at maturity or on any Redemption Date.

"**Priority Contract Contingency Reserve Amount**" means, during each Revenue Requirement Period or, for the purpose of the additional Bonds test, during the test period specified in the Indenture, the maximum amount projected by the Department to be payable by the Department under and pursuant to Priority Long Term Power Contracts in any calendar month during such Revenue Requirement Period. Each such projection shall be made at the beginning of the relevant Revenue Requirement Period. Such projections shall be based on such assumptions as the Department deems to be appropriate after consultation with the Commission and may take into account a range of possible future outcomes.

"**Priority Contract Account**" means the account by that name established under the Indenture.

"**Priority Contract Costs**" means all costs and expenses payable by the Department under or pursuant to Priority Long Term Power Contracts.

"**Priority Long Term Power Contract**" has the same meaning as that term is defined in the 2002 Rate Agreement.

"**Purchase Date**" means each date on which the Bonds of a Series shall be tendered or deemed tendered for purchase pursuant to a Supplemental Indenture.

Purchase Price" means, with respect to any Bond, 100% of the principal amount thereof plus accrued and unpaid interest, if any, plus, in the case of a Bond subject to mandatory tender for purchase on a date when such Bond is also subject to optional redemption at a premium, an amount equal to the premium that would be payable on such Bond if redeemed on such date.

"**Qualified Swap**" means, to the extent from time to time permitted by law, with respect to Bonds, (a) any financial arrangement (i) which is entered into by the Department with an entity that is a Qualified Swap Provider at the time the arrangement is entered into, (ii) which is a cap, floor or collar, forward rate, future rate, swap (such swap may be based on an amount equal either to the principal amount of such Bonds of the Department as may be designated or a notional principal amount relating to all or a portion of the principal amount of such Bonds), asset, index, price or market-linked transaction or agreement, other exchange or rate protection transaction agreement, other similar transaction (however designated), or any combination thereof, or any option with respect to any of the foregoing, executed by the Department, and (iii) which has been designated as a Qualified Swap with respect to such Bonds in a written determination signed by an Authorized Officer and filed with the Trustee and Co-Trustee, and (b) any letter of credit, line of credit, policy of insurance, surety bond, guarantee or similar instrument securing the obligations of the Department under any financial arrangement described in clause (a) above.

"**Qualified Swap Provider**" means an entity whose senior long term obligations, other senior unsecured long term obligations, financial program rating, counterparty rating, or claims paying ability, or whose payment obligations under an interest rate exchange agreement are guaranteed by an entity whose senior long term debt obligations, other senior unsecured long term obligations, financial program rating, counterparty rating, or claims paying ability, are rated at the time of the execution of such Qualified Swap either (i) at least as high as the third highest Rating Category of each Rating Agency then maintaining a rating for the Qualified Swap Provider, but in no event lower than any Rating Category designated by any such Rating Agency for the Bonds subject to such Qualified Swap, or (ii) any such lower Rating Categories which each such Rating Agency indicates in writing to the Department and the Trustee will not, by itself, result in a reduction or withdrawal of its rating on the Outstanding Bonds subject to such Qualified Swap that is in effect prior to entering into such Qualified Swap.

"**Rate Agreement**" means any agreement between the Department and the Commission pursuant to the Act and other applicable provisions of law with respect to Revenue Requirements or charges in connection with Power sold by the Department and/or Electrical Corporations, as supplemented and amended from time to time.

"**Rating Agency**" means each nationally recognized securities rating agency then maintaining a rating on the Bonds at the request of the Department.

"**Rating Category**" means one of the generic rating categories of any Rating Agency without regard to any refinement or gradation of such rating by a numerical modifier or otherwise.

"**Redemption Date**" means the date fixed for redemption of Bonds of a Series subject to redemption in any notice of redemption given in accordance with the terms of the Indenture.

"**Redemption Price**" means, with respect to any Bond or a portion thereof, the principal amount thereof to be redeemed in whole or in part, plus the applicable premium, if any, payable upon redemption thereof pursuant to such Bond or the Indenture.

"**Registrar**" means any registrar for the Bonds of any Series and its successor or successors and any other Person which may at any time be substituted in its place pursuant to the Indenture.

"**Reimbursement Obligation**" has the meaning provided under the caption "Special Provisions Relating to Enhancement Facilities, Qualified Swaps, Other Similar Arrangements and Interim Financing Notes" below.

"**Residual Net Short**" means the total electric requirements of the retail electric end-users served by and within the service areas of Electrical Corporations whose customers receive Power from the Department, minus electric generation available from both Utility Retained Generation and Department contract purchases. "Utility Retained Generation" means generating resources retained by Electrical Corporations, bilateral contracts held by Electrical Corporations and Qualifying Facility contracts. "Qualifying Facility" means a renewable power production or co-generation facility not primarily engaged in the generation or sale of electric power and that qualifies under Section 201 of the federal Public Utilities Regulatory Policy Act of 1978, the output from which facility is sold to an Electrical Corporation.

"**Responsible Officer**" means (i) with respect to the Trustee, any officer or employee of the State having direct responsibility for the administration of the Indenture, and in each case also, with respect to a particular matter, any other officer or employee to whom such matter is referred because of such officer's or employee's knowledge of and familiarity with the particular subject, and (ii) with respect to the Co-Trustee, any officer assigned to the corporate trust office of the Co-Trustee, including, but not limited to, any managing director, principal, vice president, assistant vice president, assistant treasurer, assistant secretary or any other officer of the Co-Trustee customarily performing functions similar to those performed by any of the above designated officers.

"**Revenue Requirement Period**" means any period for which the Department determines, and submits to the Commission, the Department's Revenue Requirements.

"**Revenue Requirements**" means the amounts needed from time to time by the Department to satisfy its obligations under the Enabling Measures.

"**Revenues**" means all revenues, receipts, charges, income, profits, proceeds or other moneys actually received by the Department, from whatever source, arising from or in connection with the conduct of the Department's program for the purchase and sale of Power and related activities pursuant to the Enabling Measures and Senate Bill 7X, including, but not limited to, (i) all money paid directly or indirectly to or for the account of the Department with respect to any sale, exchange, transfer or disposition of Power acquired by the Department pursuant to the Enabling Measures and Senate Bill 7X, (ii) all moneys actually received by the Department which have been recovered as compensation or damages from providers of Power or other commodities or services acquired by the Department pursuant to the Enabling Measures, provided that nothing in the Indenture shall obligate the Department to recover and actually receive moneys as such compensation or damages from such providers, (iii) net payments to the Department under Qualified Swaps and (iv) Direct Access Power Charges. Revenues shall include, but shall not be limited to, Bond Charge Revenues, Power Charge Revenues, and Direct Access Power Charge Revenues, as and when received by the Department. Revenues shall not include (a) any revenues, receipts, charges, income, profits, proceeds or other money or monetary benefits attributable directly or indirectly to the

ownership or operation of any Separately Financed Program, (b) any federal or state grant moneys to the extent receipt is conditioned upon their expenditure for a particular purpose or in a particular manner other than as provided in the Indenture for Revenues, (c) money actually received as compensation or damages recovered from providers of Power or other commodities or services acquired by the Department pursuant to the Enabling Measures, if and to the extent the Department's entitlement thereto is not final and is subject to appeal, other review or refund, (d) the proceeds of any Bonds or Subordinated Indebtedness, (e) any amounts received as a result of a deposit of moneys or Defeasance Securities for the defeasance of Bonds pursuant to the Indenture, except to the extent not required for such purpose as provided in the Indenture, and (f) the proceeds of any draw on or payment under any Enhancement Facility which is intended for the payment of particular Bonds.

"**Securities Depository**" means, with respect to Bonds of a Series, the securities depository, if any, appointed for such Bonds in a Supplemental Indenture providing with respect to the issuance and payment of such Bonds.

"**Senate Bill 7X**" means Chapter 3 of the Statutes of 2001 (Senate Bill 7 of the First Extraordinary Session) of the State.

"**Separately Financed Program**" means, collectively, (i) any program, project or purpose described as such under the caption "Separately Financed Programs" below and (ii) the State Water Resources Development System, being the system and activities authorized by the provisions of Part 3 (commencing with Section 11000) of Division 6 of the State Water Code.

"**Series**" means, subject to certain provisions of the Indenture (see "Special Provisions Relating to Enhancement Facilities, Qualified Swaps, Other Similar Arrangements and Interim Financing Notes"), all of the Bonds delivered on original issuance pursuant to a single Supplemental Indenture and denominated therein a single series, and any Bonds thereafter delivered in lieu of or in substitution therefor pursuant to certain provisions of the Indenture, regardless of variations in maturity, interest rate, or other provisions.

"**Series 2008K Bonds**" means the Department's Power Supply Revenue Bonds, Series 2008K, authorized by the Indenture, including by the Eighth Supplemental Indenture.

"**Servicing Agreement**" means any agreement, as supplemented and amended, between the Department and one or more Electrical Corporations, or, if approved by the Commission, other Persons if a Consultant advises the Trustee or Co-Trustee in writing that such other Person is reasonably expected to be capable of carrying out the provisions thereof, to provide the functions or services specified in the Indenture as agent of the Department.

"**Servicing Arrangements**" means, collectively, the Servicing Agreements and Servicing Orders, or any of them, as appropriate.

"**Servicing Order**" means each order of the Commission described below under the caption "Servicing Arrangements; Collection of Revenues."

"**Sinking Fund Installment**" means an amount so designated for the retirement prior to maturity of Bonds of a Series of like maturity and interest rate.

"**State**" means the State of California.

"**Subordinated Indebtedness**" means any bond, note or other indebtedness authorized by a resolution or indenture of the Department and permitted under the Act and designated as constituting "Subordinated Indebtedness" in a certificate of an Authorized Officer delivered to the Trustee, which shall be payable from the Trust Estate subject and subordinate to the prior payments to be made therefrom as provided for in the Indenture. Subordinated Indebtedness may be secured by a lien on and pledge of the Trust Estate junior and inferior to the lien on and pledge of the Trust Estate created in the Indenture for the payment of the Bonds and Parity Obligations to the extent permitted by the Indenture, and may also be payable from such other sources and additionally secured as provided by the Indenture.

"**Subordinated Obligation**" means any payment obligation (other than a payment obligation constituting a Parity Obligation or Subordinated Indebtedness) of the Department incurred pursuant to the Act arising under any contract, agreement or other obligation incurred pursuant to the Act not constituting Bonds, Parity Obligations, Operating Expenses,

Interim Financing Notes or the Credit and Security Agreement, provided that if such contract, agreement or other obligation is not incurred in connection with the Bonds, it shall have been approved by the Commission. Each Subordinated Obligation shall be payable from the Trust Estate subject and subordinate to the prior payments to be made therefrom as provided for in the Indenture. Subordinated Obligations may be secured by a lien on and pledge of the Trust Estate junior and inferior to the lien on and pledge of the Trust Estate created in the Indenture for the payment of the Bonds and Parity Obligations to the extent permitted by the Indenture, and may also be payable from such other sources and additionally secured as provided by the Indenture.

"**Supplemental Indenture**" means any indenture supplemental to or amendatory of the Indenture, adopted by, or adopted pursuant to authorization granted by, the Department in accordance with the Indenture.

"**Termination**" (and other forms of "terminate") means, when used with respect to any Credit Facility or Liquidity Facility, the replacement, removal, surrender or other termination of such Credit Facility or Liquidity Facility in accordance with its terms, other than an Expiration or an extension or renewal thereof.

"**Treasurer**" means the Treasurer of the State, or any successor to the rights, duties and obligations of the Treasurer under the Indenture.

"**Trustee**" means the Treasurer.

"**Trust Estate**" means, collectively:

(i) all Revenues;

(ii) all right, title and interest of the Department in and to Revenues, and all rights to receive the same; including but not limited to the assignment of amounts payable under the Servicing Arrangements as provided by the Indenture (see "Servicing Arrangements; Collection of Revenues");

(iii) the Operating Account, the Operating Reserve Account, the Bond Charge Collection Account, the Bond Charge Payment Account and the Debt Service Reserve Account, subject to the application thereof as provided in the Indenture; and

(iv) all funds, moneys and securities and any and all other rights and interests in property, whether tangible or intangible, from time to time hereafter by delivery or by writing of any kind conveyed, mortgaged, pledged, assigned or transferred as and for additional security under the Indenture for the Bonds and Parity Obligations by the Department, or by anyone on its behalf, or with its written consent, to the Trustee, which is authorized by the Indenture to receive any and all such property at any and all times, and to hold and apply the same subject to the terms of the Indenture; *provided, however,* that no such additional security shall be received, held or applied by the Trustee unless accompanied by a Counsel's Opinion to the effect that such additional security may be pledged under the Act and that it would not cause the Bonds or Parity Obligations to constitute a debt or liability of the State within the meaning of any constitutional or statutory provision or restriction, unless such constitutional or statutory provision or restriction shall have been complied with;

provided, however, that the Trust Estate shall not include, as to any Bond, any moneys or securities set aside under the Indenture specifically for the payment of other Bonds pursuant to the Indenture and, as to any Option Bond, any moneys or securities set aside for the purchase thereof as may be provided in the Indenture.

"**2001 Emergency Measures**" means all Proclamations and Orders of the Governor of the State issued in calendar year 2001 pursuant to the California Emergency Services Act (Chapter 7, Division 1, Title 2 of the California Government Code, as amended) as amended, including, but not limited to, any regulations issued pursuant thereto, issued in response to or in anticipation of the need to assure the availability of power to retail end-use customers in the State due to the inability or failure of an Electrical Corporation to purchase such power.

"**2002 Rate Agreement**" means the Rate Agreement, dated as of March 8, 2002, between the Department and the Commission, as supplemented and amended from time to time.

"**Valuation Date**" means, with respect to any Capital Appreciation Bonds, the date or dates set forth in the Supplemental Indenture authorizing such Bonds on which specific Accreted Values are assigned to the Capital Appreciation Bonds.

"**Variable Rate Bonds**" means, as of any date of determination, any Bonds on which the interest rate borne thereby may vary thereafter.

Security for the Bonds

The Bonds are special obligations of the Department, payable solely from the Trust Estate. Under the Indenture, the Trust Estate is assigned and pledged to the Trustee and Co-Trustee for the benefit of the Owners of the Bonds, the holders of the Interim Financing Notes and the holders, issuers or other parties to Parity Obligations, as security for the payment of the principal and Redemption Price of and interest on the Bonds, payment of the Interim Financing Notes and payments due under Parity Obligations, in each case in accordance with their terms and the provisions of the Indenture, subject to the use of the Trust Estate for the purposes and on the terms and conditions provided in the Indenture. The Bonds, Interim Financing Notes and Parity Obligations are not payable from any income, receipts, or revenues of the Department other than those included in the Trust Estate, except as permitted by the last sentence of this paragraph, nor do the Bonds, Interim Financing Notes or Parity Obligations constitute a legal or equitable pledge, charge, lien, or encumbrance upon any of the property or upon any of the income, receipts, or revenues of the Department, except the Trust Estate. The Bonds, Interim Financing Notes, Parity Obligations, Subordinated Obligations and Subordinated Indebtedness (i) shall not be or be deemed to constitute a debt or liability of the State or of any political subdivision thereof, other than, to the extent provided in the Indenture, the Department, or a pledge of the faith and credit of the State or of any such political subdivision, other than the Department to the extent provided in the Indenture, but are payable solely from the funds pledged therefor pursuant to the Indenture, and (ii) do not directly or indirectly or contingently obligate the State or any political subdivision thereof to levy or to pledge any form of taxation whatever therefor or to make any appropriation for their payment. Subordinated Obligations and Subordinated Indebtedness may be secured by the Trust Estate, pursuant to a Supplemental Indenture, to the extent not contrary or inconsistent with the Indenture as theretofore in effect. Nothing contained in the Indenture shall prevent an Enhancement Facility from being provided with respect to any particular Bonds, Interim Financing Notes or Parity Obligations and not others, or different reserves being provided pursuant to the Indenture with respect to Bonds than are provided for Parity Obligations, or with respect to particular Parity Obligations than are provided for other Parity Obligations.

In the Indenture the Department represents that, pursuant to California Government Code Section 5451 and California Water Code Section 80132(g), the Indenture creates a valid and binding pledge of the Trust Estate for the benefit of the Owners of the Bonds, the holders of the Interim Financing Notes and the holders, issuers or other parties to Parity Obligations, as security for the payment of the Bonds, Interim Financing Notes and Parity Obligations, respectively, to the extent set forth in the Indenture, enforceable in accordance with the terms thereof. The pledge created by the Indenture shall be valid and binding from and after the date the Indenture is executed and delivered, and the Trust Estate shall immediately be subject to the lien of the pledge without any physical delivery thereof or further act, and the lien of the pledge shall be valid and binding as against all parties having claims of any kind in tort, contract or otherwise against the Department irrespective of whether such parties have notice thereof.

Protection of Security

The Department shall at all times, to the extent permitted by law, defend, preserve and protect the pledge created by the Indenture and all interests of the Owners of Bonds, the holders of the Interim Financing Notes and the holders, issuers or other parties to Parity Obligations under the Indenture against all claims and demands of all Persons whomsoever.

Without limiting the generality of the foregoing, if any regulatory or judicial investigation of or challenge to any action taken by the Department in the performance of its obligations under the Act, the Indenture or the Rate Agreement is initiated, the Department shall take all legally available action which, in the judgment of the Department, may be necessary or desirable to assure that such challenge will not result in the inability of the Department to pay amounts payable under the Bonds, the Interim Financing Notes and Parity Obligations when due.

General Provisions for the Issuance of Bonds

Bonds may be issued pursuant to the Indenture in such principal amount or amounts for each Series of the Bonds as may be specified in the applicable Supplemental Indenture. The aggregate principal amount of the Bonds that may be executed and delivered under the Indenture is not limited except as provided in the Indenture or as may be limited by law. Bonds may be issued for any purpose of the Department authorized by the Act, including, but not limited to, the payment of Costs.

Bonds may be sold in one or more Series (each of which shall contain a designation distinguishing it from other Series), and shall be delivered by the Department under the Indenture but only upon receipt by the Trustee of, among other documents, a Supplemental Indenture authorizing the Bonds, a Counsel's Opinion with respect to validity of the Bonds, a copy of the Rate Agreement applicable to such Bonds, certificates of an authorized representative of the Commission and an Authorized Officer as to the maximum aggregate principal amount of Bonds and Subordinated Indebtedness approved by or pursuant to Rate Agreements, and a certificate of an Authorized Officer stating that, upon the delivery of such Bonds, no Event of Default as defined in the Indenture, or event which, with the giving of notice or passage of time, or both, would constitute an Event of Default, shall have occurred and be continuing.

Prior to the issuance of Bonds, the Trustee shall also receive a certificate or report of a Consultant setting forth (i) the estimated Revenues for the twenty-four (24) calendar month period commencing on the first day of the calendar month next succeeding the date of delivery of such Bonds (the "**test period**"), (ii) the estimated Debt Service, and estimated amounts payable under all Parity Obligations, during the test period, (iii) the projected Debt Service on Bonds, and projected amounts payable under Parity Obligations, projected to be issued or entered into for any purpose during the test period, (iv) the sum of the estimated and projected amounts required to be paid for Operating Expenses, Subordinated Indebtedness and Subordinated Obligations during the test period, (v) the sum of the amounts estimated and projected to be available in the Operating Account, Bond Charge Collection Account and Bond Charge Payment Account for the payment of the items of cost referred to in clauses (ii) through (iv) above at the commencement of the test period, and (vi) the balances on deposit in the Debt Service Reserve Account and Operating Reserve Account at the commencement of, and projected to be on deposit therein throughout, the test period, and showing that (1) for the test period, the sum of the amounts set forth in clauses (i) and (v) above is at least equal to 100% of the sum of the amounts set forth in clauses (ii), (iii) and (iv) above, (2) the Debt Service Reserve Account is maintained throughout the test period at an amount at least equal to the Debt Service Reserve Requirement and (3) the Operating Reserve Account is maintained throughout the test period at an amount at least equal to the Operating Reserve Account Requirement. Such certificate or report shall reflect, among other things, the issuance of such Bonds and the Debt Service estimated to be payable thereon. The Consultant may base its estimates and projections upon such factors as it shall consider reasonable, including, but not limited to, future increases in Revenue Requirements, a statement to which effect shall be included in such certificate or report. For purposes of this requirement, any Debt Service, Parity Obligations, Subordinated Indebtedness and payments shall not include any amounts thereof expected by the Department to be paid from any funds, other than Revenues, reasonably expected by the Department to be available therefor (including, without limitation, the anticipated receipt of proceeds of sale of Bonds or Subordinated Indebtedness, or moneys not a part of the Trust Estate), which expectations, if included in a written determination signed by an Authorized Officer and filed with the Trustee, shall be conclusive. This paragraph shall not apply to (w) the initial Series of Bonds, (x) any Bonds assumed to be issued as part of the plan of finance of the Department's program for the purchase and sale of Power, as described in the public offering statement issued by the Department in connection with the initial Series of Bonds, (y) any Bonds issued to refund any other Bonds, and (z) any Bonds issued to refund bonds, notes or other evidences of indebtedness issued in anticipation of the issuance of such Bonds, if the requirements of this paragraph shall have been satisfied upon issuance of such bonds, notes or other evidences of indebtedness, assuming for such purpose that they are Bonds with principal due based upon level amortization of principal and interest over a period commencing on the date of issue and ending on the latest maturity date of any Bonds, and bearing interest as described for Bonds in the definition of Debt Service.

Separately Financed Programs

Nothing in the Indenture shall prevent the Department from authorizing and issuing bonds, notes, or other obligations or evidences of indebtedness, other than Bonds, Parity Obligations, Subordinated Indebtedness or Subordinated Obligations, for any program, project or purpose authorized by the Enabling Measures or by other then applicable State statutory provisions, or from financing any such program, project or purpose from other available funds (a "Separately Financed Program"), if the debt service on such bonds, notes, or other obligations or evidences of indebtedness, if any, and the Department's share of any operating expenses related to such program, are not payable from the Trust Estate.

Special Provisions Relating to Enhancement Facilities, Qualified Swaps, Other Similar Arrangements and Interim Financing Notes

Any Supplemental Indenture may provide that:

(a) So long as an Enhancement Facility relating to any Series of Bonds is in full force and effect, and the issuer of the Enhancement Facility is not in default thereunder, then, in all such events, the Supplemental Indenture for such Series of Bonds may specify that either (i) the issuer of such Enhancement Facility shall be deemed to be the sole Owner of the Outstanding Bonds the payment of which such Enhancement Facility secures or secured when the approval, consent or action of the Owners of such Bonds is required or may be exercised under the Indenture, or (ii) the approval, consent or action of the issuer of such Enhancement Facility shall be required in addition to the approval, consent or action of the applicable percentage of the Owners of the Outstanding Bonds the payment of which such Enhancement Facility secures or secured when the approval, consent or action of the Owners of such Bonds is required or may be exercised under the Indenture.

(b) In the event that the principal, Sinking Fund Installments, if any, Purchase Price and Redemption Price, if applicable, or interest due on any Outstanding Bonds shall be paid under the provisions of an Enhancement Facility, all covenants, agreements and other obligations of the Department to the Owners of such Bonds shall continue to exist, and the issuer of the Enhancement Facility shall be subrogated to the rights of such Owners in accordance with the terms of such Enhancement Facility.

In addition, such Supplemental Indenture may establish such provisions as are necessary (i) to comply with the provisions of any Enhancement Facility that are not inconsistent with the Indenture, (ii) to provide relevant information and notices to the issuer of the Enhancement Facility, and (iii) to provide a mechanism for paying principal of and Sinking Fund Installments of and interest on Bonds secured by, or purchased pursuant to, the Enhancement Facility.

The Department may enter into agreements with the issuer of any Enhancement Facility providing for, among other things: (i) the payment of fees, costs, expenses and, to the extent permitted by law, indemnities to such issuer, its parent and its assignees and participants in connection with such Enhancement Facility, (ii) the terms and conditions of such Enhancement Facility and the Bonds to which the Enhancement Facility relates, and (iii) the security, if any, to be provided for the issuance of such Enhancement Facility. Any such agreement may provide for the purchase of Bonds to which the Enhancement Facility relates by the issuer of such Enhancement Facility, with such adjustments to the rate of interest, method of determining interest, maturity (which shall not be inconsistent with the requirements of the next paragraph), or redemption provisions, as shall be specified by the Supplemental Indenture authorizing the issuance of such Bonds.

The Department may, in an agreement with the issuer of any Enhancement Facility, agree to directly reimburse such issuer (or its assignees and participants, or any agent for the issuer or its assignees) for amounts paid by the issuer of the Enhancement Facility for the payment of the principal of, interest on, and Redemption Price or Purchase Price of Bonds under the terms of such Enhancement Facility (together with interest thereon, if any, and the amounts and obligations described in the next following two paragraphs, a "**Reimbursement Obligation**"), whether evidenced by an obligation to reimburse such issuer that is separate from the Department's obligations on Bonds (a "**Credit Facility Reimbursement Obligation**") or by modified debt service obligations on Bonds acquired by such issuer (a "**Liquidity Facility Reimbursement Obligation**"); *provided, however,* that no such obligation to reimburse or modified debt service obligation shall require payments, other than from remarketing proceeds, to be made faster than on a level debt service (principal and interest) basis (calculated in three (3) month intervals) over a period ending no sooner than three (3) years following the date on which such reimbursement obligation is incurred (or, if less, extending to the final maturity date of the related Bonds) with the first installment commencing no earlier than six (6) months after the date from which the Liquidity Facility Reimbursement Obligation is incurred; and provided further, however, that the immediately preceding proviso shall not apply to any amounts payable to any issuer of any policy of bond insurance that is a subrogee of an Owner of Bonds with respect to amounts payable by the Department under such Bonds, or to any Alternate Debt Service Reserve Account Deposit. Notwithstanding anything to the contrary contained in this paragraph, no Reimbursement Obligation shall be created, for purposes of the Indenture, until amounts are paid under the related Enhancement Facility.

Any Credit Facility Reimbursement Obligation may include interest calculated at a rate higher than the interest rate on the related Bond. The following obligations also shall constitute Credit Facility Reimbursement Obligations: (i) payments of any fees, costs, expenses, indemnification, or other obligations to any such provider, its parent and its assignees and participants or any agent thereof, and (ii) payments pursuant to any advance, term-loan or other principal amortization requirements in reimbursement of any such advance or term-loan, provided that the total amount to be paid (including

interest thereon) either (a) shall not be required to be paid faster than on a level debt service (principal and interest) basis (calculated in three (3) month intervals) over a period ending no sooner than three (3) years following the date on which such reimbursement obligation is incurred, with the first installment commencing no earlier than six (6) months after the date from which the Reimbursement Obligation is incurred, or (b) shall be paid from remarketing proceeds.

Any Liquidity Facility Reimbursement Obligation evidenced by Bonds of a Series may include interest calculated at a rate higher than the interest rate on other Bonds of such Series. The following obligations also shall constitute Liquidity Facility Reimbursement Obligations: (i) payments of any fees, costs, expenses, indemnification, or other obligations to any such provider, its parent and its assignees and participants, or any agent thereof, and (ii) payments of differential and/or excess interest amounts.

In connection with the issuance of any Bonds or at any time thereafter so long as Bonds remain Outstanding, the Department may, to the extent from time to time permitted pursuant to law, enter into Qualified Swaps. The total amount of the termination payment under a Qualified Swap, shall not be required to be paid by the Department faster than on a level amortization basis (calculated in three (3) month intervals) over a period ending no sooner than three (3) years following the date of termination, with the first installment commencing no earlier than six (6) months after the date of termination (in which case the termination payment also may include interest thereon); *provided, however,* that if the Department elects to terminate any Qualified Swap at its option, any termination payments shall be made as provided in such Qualified Swap.

For purposes of the Articles of the Indenture relating to the Trustee, Co-Trustee, Paying Agents and Registrar, Supplemental Indentures (except for provisions relating to the issuance of Bonds and certain specified amendments to the Indenture without the consent of Owners), amendments to the Indenture with the consent of Owners, Events of Defaults (except those described in (1), (2) and (6) under "Events of Default and Remedies" below) and remedies, defeasance and other miscellaneous provisions, and otherwise unless the context otherwise requires, references to "Bond" shall also include each Interim Financing Note, references to "Series" or "Series of Bonds" shall also include as a Series all outstanding Interim Financing.

Notes, and references to "Owner" shall also include the holder of any Interim Financing Note.

Establishment of Funds

The Indenture establishes in the Electric Power Fund seven separate accounts, to be known as the "Operating Account," the "Priority Contract Account," the "Bond Charge Collection Account," the "Bond Charge Payment Account," the "Debt Service Reserve Account," the "Operating Reserve Account" and the "Administrative Cost Account." The Department may establish under the Indenture one or more additional funds, accounts or subaccounts, if not inconsistent with any Rate Agreement, by delivering to the Trustee a direction to that effect signed by an Authorized Officer, except to the extent the establishment thereof is required by other provisions of the Indenture.

The Operating Account, the Priority Contract Account, the Operating Reserve Account, the Bond Charge Collection Account and the Administrative Cost Account shall be under the control of the Department, except if an Event of Default shall happen and shall not have been remedied, in which case the Operating Account, the Priority Contract Account, the Operating Reserve Account, the Bond Charge Collection Account and the Administrative Cost Account shall be under the control of the Treasurer as Trustee. The Bond Charge Payment Account and the Debt Service Reserve Account shall be under the control of the Treasurer as Trustee at all times; *provided, however,* that moneys in the Bond Charge Payment Account may be held by any Paying Agent to the extent determined by the Trustee to be necessary or desirable as an administrative convenience.

All moneys and securities deposited under the Indenture in any fund, account or subaccount shall be held in trust for the benefit of the Department, the Owners of the Bonds, the holders of the Interim Financing Notes, and the parties to or holders of Parity Obligations, in each case to the extent provided in the Indenture, and applied only in accordance with the provisions of the Indenture, and each of such funds, accounts and subaccounts shall be a trust fund for purposes set forth in the Indenture.

Application and Flow of Funds

In this caption any references to sections or subsections refer to sections and subsections in this "Application and Flow of Funds" caption.

A. Operating Account. 1. The Department shall pay or cause to be paid into the Operating Account, (i) upon the delivery of the initial Series of Bonds, all moneys and securities on deposit in the Electric Power Fund, except as may be provided by Supplemental Indenture, (ii) as and when received, all net proceeds of Bonds, except as may be provided by Supplemental Indenture, and (iii) all Power Charge Revenues and other Revenues, other than Bond Charge Revenues and payments to the Department under Qualified Swaps relating to Bonds. Net proceeds of Bonds shall be paid out or transferred pursuant to section A.2 below. Other amounts in the Operating Account shall be paid out, transferred, retained, accumulated or withdrawn from time to time for the following purposes and, as of any time, in the following order of priority:

(a) Amounts in the Operating Account shall be transferred to the Priority Contract Account on or before the fifth Business Day of each month in such amount as is necessary to make the amount in the Priority Contract Account sufficient to pay Priority Contract Costs estimated to be due during the balance of such month and for the first five Business Days of the next succeeding month. Additional amounts in the Operating Account also shall be transferred to the Priority Contract Account, at any time, to the extent amounts on deposit in the Priority Contract Account are insufficient to pay Priority Contract Costs then payable. Amounts on deposit in the Priority Contract Account shall be used solely to pay Priority Contract Costs then payable.

(b) Amounts in the Operating Account shall be applied to the payment of Operating Expenses then due and owing, other than Priority Contract Costs and any other costs specified in another paragraph of this section A.1, *provided, however,* that Operating Expenses that constitute administrative costs described in section G below shall be paid through the Administrative Cost Account pursuant to section G below subject to the priority afforded Priority Contract Costs pursuant to section A.1(a).

(c) Amounts in the Operating Account shall be applied to the payment of the Interim Financing Notes and other amounts payable by the Department under the Credit and Security Agreement, as and when due and payable.

(d) Amounts in the Operating Account shall be withdrawn and deposited in the Bond Charge Collection Account to reimburse the Bond Charge Collection Account for any amounts previously transferred therefrom (i) pursuant to section C.1 below, to the Priority Contract Account for the payment of Priority Contract Costs, and (ii) pursuant to section C.1(b) below, to the Operating Account for the payment of the Interim Financing Notes and other amounts payable by the Department under the Credit and Security Agreement.

(e) Amounts in the Operating Account shall be applied as provided by section D.7 below but only to the extent not paid from the Bond Charge Payment Account. In addition, prior to the time Bond Charge Revenues are received in the amounts sufficient to make the transfers required by section D.1 below, amounts in the Operating Account shall be transferred to the Bond Charge Payment Account in the amounts, at the times and otherwise as required by said section D.1.

(f) Amounts in the Operating Account shall be withdrawn to deposit in the Debt Service Reserve Account amounts as provided by section E below, but only to the extent such deposit is required as a result of (i) the use of Bond Charge Revenues for the payment of Priority Contract Costs, or for the payment of the Interim Financing Notes or other amounts payable by the Department under the Credit and Security Agreement, pursuant to section C.1(a) or C.1(b) below, or (ii) a change in value of Authorized Investments on deposit in the Debt Service Reserve Account.

(g) Amounts in the Operating Account shall be withdrawn to repay to the General Fund of the State advances made to the Department from amounts appropriated to the Electric Power Fund after November 15, 2001, including interest thereon payable at the Pooled Money Investment Rate, to the extent not theretofore repaid. The Department shall file with the Trustee, on or prior to the delivery of the initial Series of Bonds, a statement of the outstanding amount required to be repaid to the General Fund and promptly shall revise the same, and file such revised statement with the Trustee, upon each repayment until no amount remains to be repaid.

(h) Amounts in the Operating Account shall be withdrawn to repay to the General Fund of the State advances made to the Department from amounts appropriated to the Electric Power Fund, and General Fund moneys expended by the Department pursuant to the 2001 Emergency Measures, on or prior to November 15, 2001, including interest payable thereon at the Pooled Money Investment Rate, to the extent not theretofore repaid, in accordance with the schedule described in the immediately succeeding sentence. At such time as a schedule is established by the Commission for repayments to the General Fund described in this section A.1(h), the Department shall file such schedule with the Trustee, and shall promptly file with the Trustee each revised schedule that is similarly established until no amount remains to be repaid.

(i) Amounts in the Operating Account shall be withdrawn to deposit in the Operating Reserve Account amounts as provided by section F below.

(j) Amounts in the Operating Account shall be withdrawn for the following purposes, on a parity basis:

(i) to pay the principal of and interest on any Subordinated Indebtedness, and the redemption price or purchase price of Subordinated Indebtedness payable from mandatory sinking fund installments therefor,

(ii) to the extent not paid from the proceeds of Subordinated Indebtedness, to pay costs of issuing Subordinated Indebtedness or costs incidental to their payment and security,

(iii) to pay amounts due under any Subordinated Obligation, but only to the extent not paid from the Bond Charge Payment Account, and

(iv) to establish and maintain reserves for the payment of Subordinated Indebtedness or Subordinated Obligations to the extent required by a Financing Document; *provided, however,* that such a reserve may also be accumulated in the Operating Account. Any such reserve for Subordinated Indebtedness or Subordinated Obligations accumulated in the Operating Account shall be maintained in a separate subaccount which shall be established therein for such respective purpose pursuant to the Indenture.

(k) Amounts remaining in the Operating Account may be withdrawn for any purpose relating to the Department's program for the purchase and sale of Power and related activities only as permitted under the Enabling Measures, to the extent not specified in sections A.1(a) through A.1.(j) above, as determined by the Department, including, without limitation, to pay or provide for the purchase or redemption of Bonds or Subordinated Indebtedness, and the payment of expenses in connection therewith to the extent not constituting Operating Expenses. Purchases of Bonds or Subordinated Indebtedness from amounts in the Operating Account pursuant to this section A.1(k) shall be made at the written direction of an Authorized Officer filed with the Trustee, with or without advertisement and with or without notice to other Owners of Bonds or Subordinated Indebtedness. Such purchases shall be made at such price or prices as determined by the Department, subject to limitations, if any, of the Supplemental Indenture authorizing the issuance of such Series of Bonds; *provided, however,* that such purchases shall be made at prices exceeding the next applicable Redemption Price (or, if none, the principal amount) of such Bonds, plus accrued interest, if any, only after consultation with the Commission and if the Department determines that to do so will not result in any insufficiency in the Operating Account or the Bond Charge Payment Account for any other purpose.

It shall be a condition to any withdrawal pursuant to sections A.1(j) and A.1(k) above that (1) there shall be no deficiency in either the Debt Service Reserve Account or the Operating Reserve Account without regard to the operation of the provisions of sections E.3, E.6 and F.4 permitting the replenishment thereof over time, and (2) the Department shall have determined, taking into account, among other considerations, anticipated future receipts of Revenues and other moneys constituting part of the Trust Estate, that the funds to be so withdrawn are not, and are not expected to be, needed for any of the purposes set forth in any prior lettered paragraph of this section A.1.

Notwithstanding the foregoing provisions of this section A.1, if at any time the Department determines that Power Charge Revenues are available for any of the purposes set forth in sections A.1(j) or A.1(k) above, (i) such Power Charge Revenues shall instead be used to satisfy any remaining outstanding amounts due under the Interim Financing Notes and the Credit and Security Agreements and to the General Fund of the State (without regard to any schedule for repayment referred to in section A.1(h) above), and to replenish any deficiency in the Debt Service Reserve Account and the Operating Reserve Account (without regard to the provisions of the Indenture sections E.3, E.6 and F.4 below permitting the replenishment thereof over time), in the order of priority established by the Indenture as described in section A.1 above, until the Interim Financing Notes, the Credit and Security Agreement and the General Fund, and all interest as described in sections A.1(g) and A.1(h) above shall be paid in full, and there shall be no deficiency in the Debt Service Reserve Account or the Operating Reserve Account, and (ii) after all outstanding amounts due under the Interim Financing Notes and Credit and Security Agreement, and to the General Fund of the State, and all interest payable as described by sections A.1(g) and A.1(h) above, shall be paid in full, and any deficiency in the Debt Service Reserve Account and the Operating Reserve Account shall be replenished, any use of such Power Charge Revenues for any of the purposes set forth in such sections A.1(j) and A.1(k) above shall require the consent of the Commission.

2. Amounts in the Operating Account representing proceeds of each Series of Bonds shall be paid out or transferred from time to time by the Department to pay Costs of the Department, subject to limitations, if any, of the Supplemental Indenture authorizing the issuance of such Series of Bonds.

3. That amount, if any, set aside by the Department as reserves in subaccounts in the Operating Account for the purposes specified in clause (iv) of section A.1(j) above shall be used by the Department solely for the respective purposes specified in said clauses, shall not be available for the payment of any other purpose for which amounts in the Operating Account may be applied, and shall not constitute part of the Trust Estate.

4. The Department shall separately notify the Commission in writing whenever the Minimum Operating Expense Available Balance has been reduced as a result of the Department no longer purchasing the Residual Net Short. Whenever such reduction in the Minimum Operating Expense Available Balance occurs, any resulting excess in the Operating Account shall be utilized in the same manner as Excess Amounts are required to be utilized pursuant to section F.5 below.

5. While the Department is purchasing the Residual Net Short, if on any date the Operating Account balance falls below $750 million, unless the Operating Account balance has been restored to at least the Minimum Operating Expense Available Balance on the thirty-first (31st) day thereafter, then on or prior to the forty-fifth (45th) day following the date on which the Operating Account balance fell below $750 million, the Department will submit a new Revenue Requirement to the Commission providing for Revenues sufficient to restore the Operating Account to the Minimum Operating Expense Available Balance within a period ending no later than two hundred forty (240) days following the date of the submission of such new Revenue Requirement to the Commission. While the Department is purchasing the Residual Net Short, if on any date the Operating Account balance falls below $500 million and the Department has not yet submitted a Revenue Requirement pursuant to the preceding sentence, then on or prior to the earlier of (a) the tenth (10th) Business Day following the date on which the Operating Account balance falls below $500 million or (b) the date on which a Revenue Requirement is required to be submitted to the Commission in accordance with the preceding sentence, the Department will submit a new Revenue Requirement to the Commission providing for Revenues sufficient to restore the Operating Account to the Minimum Operating Expense Available Balance within a period ending no later than two hundred forty (240) days following the date of the submission of such new Revenue Requirement to the Commission.

6. If and when the Department no longer is responsible for the payment of costs under any Power Supply Contract, all amounts in the Operating Account shall be utilized in the same manner as Excess Amounts are required to be utilized pursuant to section F.5 below, *provided, however,* that amounts required to satisfy a particular contingency shall be retained in the Operating Account only until the contingency has been satisfied or discharged; and provided further, however, that there may be retained in the Operating Account the amount, if any, determined by the Department to be required to pay Bond Related Costs that otherwise would have to be paid from the Bond Charge Payment Account pursuant to section D.1(d) below; and provided further, however, that any amounts not required for the purposes described in the preceding provisos shall be utilized in the same manner as Excess Amounts are required to be utilized pursuant to section F.5 below.

B. Priority Contract Account. 1. Amounts transferred to the Priority Contract Account from the Operating Account pursuant to A.1(a) above, from the Operating Reserve Account pursuant to F.3 below or from the Bond Charge Collection Account pursuant to C.1(a) below shall be applied solely to the payment of Priority Contract Costs.

2. If and when the Department no longer is responsible for the payment of costs under any Priority Long Term Power Contract, the balance if any, on deposit in the Priority Contract Account shall be utilized in the same manner as Excess Amounts are required to be utilized pursuant to section F.5 below.

C. Bond Charge Collection Account. 1. The Department shall pay or cause to be paid into the Bond Charge Collection Account, as and when received, (i) all Bond Charge Revenues, and (ii) all payments to the Department under Qualified Swaps relating to Bonds. Bond Charge Revenues shall be paid out, transferred, retained, accumulated or withdrawn from time to time for the following purposes and, as of any time, in the following order of priority:

(a) Amounts in the Bond Charge Collection Account shall be withdrawn and deposited in the Priority Contract Account, upon the written direction of an Authorized Officer filed with the Trustee, for the purpose of paying Priority Contract Costs then due and payable, but only to the extent moneys are not available for such purpose in the Operating Account, the Priority Contract Account or the Operating Reserve Account; *provided, however,* that no such withdrawal shall

be made if and when the Department no longer responsible and liable for the payment of costs under any Priority Long Term Power Contract.

(b) Amounts in the Bond Charge Collection Account shall be withdrawn and deposited in the Operating Account, upon the written direction of an Authorized Officer filed with the Trustee, for the purpose of paying the principal of and interest on the Interim Financing Notes and other amounts payable by the Department under the Credit and Security Agreement, as and when due and payable, but only to the extent moneys are not available for such purpose in the Operating Account or in the Operating Reserve Account.

(c) Amounts in the Bond Charge Collection Account shall be transferred to the Bond Charge Payment Account and applied for the purposes of, in the amounts and at the times required by, and otherwise as provided in section D below.

(d) Amounts in the Bond Charge Collection Account shall be withdrawn for the following purposes, on a parity basis:

(i) to deposit in the Debt Service Reserve Account amounts as provided by section E below, but only to the extent amounts are not available therefor pursuant to section A.1(f) above, and

(ii) upon the written direction of an Authorized Officer filed with the Trustee, to establish and maintain reserves for the payment of Parity Obligations to the extent required by a Financing Document. Any such reserve for Parity Obligations accumulated in the Bond Charge Collection Account shall be maintained in a separate subaccount which shall be established by a supplemental indenture for such purpose pursuant to the Indenture.

2. That amount, if any, set aside as reserves in subaccounts in the Bond Charge Collection Account pursuant to clause (ii) of section C.1(d) above shall be used by the Department solely for the respective purposes specified in said clause, shall not be available for the payment of any other purpose for which amounts in the Bond Charge Payment Account may be applied, and shall not constitute part of the Trust Estate.

D. Bond Charge Payment Account. 1. There shall be transferred from the Bond Charge Collection Account to the Bond Charge Payment Account pursuant to section C.1(c) above, no later than the last Business Day of each calendar month, the amount, if any, required so that the balance in the Bond Charge Payment Account and available for Bond Related Costs as specified below shall at least equal the respective amounts as follows, on a parity basis:

(a) the Debt Service accrued and unpaid as of such Business Day and to accrue thereafter through the end of the third next succeeding calendar month;

(b) the amount accrued and unpaid as of such Business Day and estimated to be payable in the next succeeding three calendar months (i) under Reimbursement Obligations, (ii) under agreements, constituting Parity Obligations, relating to other financial instruments entered into in connection with the Bonds, including, but not limited to, investment agreements, hedges, interest rate swaps, caps, options and forward purchase agreements, (iii) under agreements, relating to the remarketing of Bonds, including, but not limited to, remarketing agreements, dealer agreements and auction agent agreements, (iv) for any Subordinated Obligations constituting Bond Related Costs, and (v) otherwise as may be permitted by a Rate Agreement to be paid from Bond Charge Revenues or the Bond Charge Payment Account;

(c) the amount accrued and unpaid as of such Business Day and estimated to be payable in the next succeeding three (3) calendar months for the cost to the Department of Fiduciaries associated with the issuance and administration of the Bonds; and

(d) if and when the Department no longer is responsible for the payment of costs under any Power Supply Contract and Bonds remain Outstanding, the amount accrued and unpaid as of such Business Day and estimated to be payable in the next succeeding three (3) calendar months for the Department's Bond Charge servicing costs, costs of preparing and providing the information and reports required under the Financing Documents, the 2002 Rate Agreement and the Act, related audit, legal and consulting costs, related administrative costs, and costs of complying with arbitrage restrictions and rebate requirements, and otherwise as may be permitted by a Rate Agreement to be paid from Bond Charge Revenues or the Bond Charge Collection Account to the extent moneys are not available therefor in the Operating Account; *provided, however,* that administrative costs described in section G below shall be paid through the Administrative Cost Account pursuant to section G below.

For the purpose of computing the amount to be deposited in the Bond Charge Payment Account pursuant to the foregoing provisions of this section D, there shall be excluded from the balance in the Bond Charge Payment Account (i) the amount, if any, set aside in the Bond Charge Payment Account from the proceeds of Bonds for the payment of interest on Bonds which, pursuant to section D.6 below, is to be applied on an interest payment date or dates occurring after the period specified above in this paragraph, and (ii) amounts scheduled to be paid by the Department under Qualified Swaps within the relevant period. The estimates required by the foregoing provisions of this section D shall be made by the Department, based on such assumptions and projections as the Department deems to be appropriate after consultation with the Commission, and shall be included in a written direction of an Authorized Officer filed with the Trustee.

In addition to the foregoing provisions of this section D, there shall be transferred from the Bond Charge Collection Account to the Bond Charge Payment Account, no later than the time required to make the payments required by section D.3 below, the amount, if any, required, in good funds, so that the balance in the Bond Charge Payment Account and available for the purpose shall at least equal the amount required to be paid pursuant to such section D.3 below at such time.

2. The Redemption Price of any Bonds called for redemption, other than to satisfy Sinking Fund Installment requirements, may be deposited in the Bond Charge Payment Account from the Bond Charge Collection Account or, pursuant to section A.1(k) above, from the Operating Account, in the amounts and at the times required therefor, in each case subject to any limitation set forth in any conditional notice of redemption as permitted by the Indenture. The Redemption Price of any Bonds called for redemption to satisfy Sinking Fund Installment requirements shall be deposited in the Bond Charge Payment Account pursuant to section D.1(a) above.

3. The Trustee shall pay Bond Related Costs out of the Bond Charge Payment Account as follows:

(a) The Trustee shall pay to the respective Paying Agents (i) on or before each interest payment date for any of the Bonds, whether scheduled or upon earlier redemption, the amount required for the interest payable on such date; (ii) on or before each Principal Installment due date, the amount required for the Principal Installment payable on such date; and (iii) on or before any redemption date for the Bonds, to the extent of moneys deposited in the Bond Charge Payment Account therefor, the amount required for the payment of the Redemption Price of the Bonds then to be redeemed. Such amounts shall be applied by the Paying Agents to such purposes on or before the due dates thereof.

(b) The Trustee shall pay to the holder or issuer of each Parity Obligation specified in section D.1(b) above and their participants to which an amount is due and payable thereunder, or other Person to whom an amount specified in such section D.1(b) above is due and payable, such amounts and at such times, as shall be specified in a written direction of an Authorized Officer filed with the Trustee.

(c) The Trustee shall pay to each Person to whom an amount specified in section D.1(c) above is due and payable, in such amounts and at such times as shall be specified in a written direction of an Authorized Officer filed with the Trustee.

(d) The Trustee shall pay to each Person to whom an amount specified in section D.1(d) above is due and payable, in such amounts and at such times as shall be specified in a written direction of an Authorized Officer filed with the Trustee.

4. Amounts accumulated in the Bond Charge Payment Account with respect to any Sinking Fund Installment (together with amounts accumulated therein with respect to interest on the Bonds for which such Sinking Fund Installment was established) may and, if so directed in writing by an Authorized Officer, shall be applied by the Trustee, on or prior to the forty-fifth (45th) day preceding the due date of such Sinking Fund Installment, to (i) the purchase of Bonds of the Series, maturity and interest rate within each maturity for which such Sinking Fund Installment was established, subject to section D.10 below, or (ii) the redemption at the applicable sinking fund Redemption Price of such Bonds, if then redeemable by their terms. The applicable sinking fund Redemption Price (or principal amount of maturing Bonds) of any Bonds so purchased or redeemed shall be deemed to constitute part of the Bond Charge Payment Account until such Sinking Fund Installment date, for the purpose of calculating the amount of such Account. After the forty-fifth (45th) day preceding the due date of any such Sinking Fund Installment, the Trustee shall proceed to call for redemption, by giving notice as provided in the Indenture, on such due date, Bonds of the Series, maturity and interest rate within each maturity for which such Sinking Fund Installment was established (except in the case of Bonds maturing on a Sinking Fund Installment date) in such amount as shall be necessary to complete the retirement of the unsatisfied balance of such Sinking Fund Installment after

making allowances for any Bonds purchased or redeemed which the Department has directed the Trustee to apply as a credit against such Sinking Fund Installment as provided in section D.5 below.

5. If at any time Bonds of any Series or maturity for which Sinking Fund Installments shall have been established are purchased or redeemed other than pursuant to section D.4 above, or are deemed to have been paid pursuant to the Indenture, and, with respect to such Bonds which are deemed paid, irrevocable instructions have been given to the Trustee to redeem or purchase the same on or prior to the due date of the Sinking Fund Installment to be credited under this section D, an Authorized Officer may from time to time and at any time by written notice to the Trustee specify the portion, if any, of such Bonds so purchased, redeemed or deemed to have been paid and not previously applied as a credit against any Sinking Fund Installment which are to be credited against future Sinking Fund Installments for such Bonds, but in all cases subject to section D.10 below. Such notice shall specify the amounts of such Bonds to be applied as a credit against such Sinking Fund Installment or Installments and the particular Sinking Fund Installment or Installments against which such Bonds are to be applied as a credit; *provided, however,* that none of such Bonds may be applied as a credit against a Sinking Fund Installment to become due less than forty-five (45) days after such notice is delivered to the Trustee. All such Bonds which have been purchased or redeemed and are to be applied as a credit shall be surrendered to the Trustee for cancellation on or prior to the due date of the Sinking Fund Installment against which they are being applied as a credit. The portion of any such Sinking Fund Installment remaining after the deduction of any such amounts credited toward the same (or the original amount of any such Sinking Fund Installment if no such amounts shall have been credited toward the same) shall constitute the unsatisfied balance of such Sinking Fund Installment for the purpose of calculation of Sinking Fund Installments due on a future date.

6. The amount, if any, deposited in the Bond Charge Payment Account from the proceeds of any Series of Bonds shall be applied to the payment of interest on the Bonds, or paid to the issuers of Enhancement Facilities to satisfy Reimbursement Obligations relating to such interest, if any, paid under such Enhancement Facilities, in accordance with written directions signed by an Authorized Officer and filed with the Trustee or, in the event that the Department shall modify or amend any such direction by a subsequent direction signed by an Authorized Officer of the Department and filed with the Trustee, then in accordance with the most recent such direction or amended direction.

7. If at any time the amount in the Bond Charge Payment Account shall be less than the amount required to be on deposit pursuant to paragraphs (a), (b) and (c) of section D.1 above at the times required thereby, or to pay the items of cost specified in paragraphs (a), (b) and (c) of section D.3 above when due and payable, the Department shall apply all available amounts, if any, in the Operating Account to such deposits or payments, as the case may be, on parity basis. If at any time, after the application of moneys pursuant to the preceding sentence, the amount in the Bond Charge Payment Account shall be less than the amount required to pay the items of cost specified in paragraphs (a), (b) and (d) of said section D.3, all available amounts, if any, in the Debt Service Reserve Account shall be applied to such purposes on a parity basis. Any such application of moneys from the Operating Account or the Debt Service Reserve Account may be made directly or through the Bond Charge Payment Account.

8. In the event of the refunding of any Bonds, the Trustee shall, upon the written direction of an Authorized Officer, withdraw from the Bond Charge Payment Account all or any portion of amounts accumulated therein with respect to the principal of and redemption premium, if any, and interest on the Bonds being refunded and apply such amounts in accordance with such direction; *provided, however,* that such withdrawal shall not be made unless (i) immediately thereafter the Bonds being refunded shall be deemed to have been paid pursuant to the Indenture, and (ii) subject to section D.9 below, the amount remaining in the Bond Charge Payment Account with respect to Debt Service on Bonds, after such withdrawal, shall be sufficient to satisfy the requirements of section D.1 above.

9. Whenever there shall be held in the Bond Charge Payment Account, and in the Debt Service Reserve Account, without giving effect to any Alternate Debt Service Reserve Account Deposit, an aggregate amount sufficient to pay in full all Outstanding Bonds in accordance with their terms (including the maximum amount of principal or applicable sinking fund Redemption Price and interest which could become payable thereon), no transfers shall be required to be made to the Bond Charge Payment Account.

10. Any purchases of Bonds pursuant to sections D.4 and D.5 above shall be made at the direction of an Authorized Officer filed with the Trustee, with or without advertisement and with or without notice to other Owners of Bonds. Such purchases shall be made at such price or prices as is determined by an Authorized Officer; *provided, however,* that such purchases may be made at prices exceeding the next applicable Redemption Price (or, if none, the principal amount)

of such Bonds, plus accrued interest, if any, only after consultation with the Commission and if the Department determines that to do so will not result in any insufficiency in the Bond Charge Payment Account for any other purpose.

E. Debt Service Reserve Account. 1. At the time any Series of Bonds is delivered pursuant to the Indenture, the Department shall pay into the Debt Service Reserve Account from the proceeds of such Bonds or other available funds, the amount, if any, necessary for the amount on deposit in the Debt Service Reserve Account to equal the Debt Service Reserve Requirement, after giving effect to any Alternate Debt Service Reserve Account Deposit, calculated immediately after the delivery of such Series of Bonds.

2. Amounts on deposit in the Debt Service Reserve Account shall be applied as provided in this section E and section D.7 above. Fiduciary charges and expenses (including, but not limited to, legal fees and expenses) shall not be paid from the Debt Service Reserve Account.

3. If a deficiency exists in the Debt Service Reserve Account, no later than the last Business Day of each calendar month the Department shall transfer (i) to the extent such transfer is required as a result of the use of Bond Charge Revenues for the payment of Priority Contract Costs, or the payment of the principal of and interest on the Interim Financing Notes and other amounts payable by the Department under the Credit and Security Agreement, pursuant to section C.1(a) or C.1(b) above, or a change in value of investments, first, from the Operating Account to the extent that there are sufficient moneys available therein, pursuant to section A.1(f) above, and second, to the extent necessary, from the Bond Charge Collection Account, to the extent that there are sufficient moneys available therein, pursuant to clause (i) of section C.1(d) above, and (ii) to the extent such transfer is required otherwise than as described in clause (i), or in the event transfers pursuant to clause (i) are not sufficient, from the Bond Charge Collection Account to the extent that there are sufficient moneys available therein, and deposit in the Debt Service Reserve Account the amount, if any, required for the amount on deposit in the Debt Service Reserve Account to equal the Debt Service Reserve Requirement as of the last day of such calendar month, after giving effect to any Alternate Debt Service Reserve Account Deposit; *provided, however,* that any deficiency in the Debt Service Reserve Account, after giving effect to any Alternate Debt Service Reserve Account Deposit, may be cured by depositing into the Debt Service Reserve Account each month during the period commencing no later than the seventh month following such determination of the deficiency, approximately equal or greater amounts such that the deficiency shall be cured by no later than the twelfth month following such determination of the deficiency.

4. Any amount in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement, after giving effect to any Alternate Debt Service Reserve Account Deposit, may be retained therein or, upon the written direction of an Authorized Officer filed with the Trustee, may be transferred to the Bond Charge Collection Account; *provided, however,* that any such excess as of the last Business Day of each calendar year shall be so transferred.

5. Whenever the amount in the Debt Service Reserve Account, without giving effect to any Alternate Debt Service Reserve Account Deposit, together with the amount in the Bond Charge Payment Account with respect to Debt Service on Bonds, is sufficient to pay in full all Outstanding Bonds in accordance with their terms (including the maximum amount of principal or applicable sinking fund Redemption Price and interest which could become payable thereon), the funds on deposit in the Debt Service Reserve Account shall be transferred to the Bond Charge Payment Account, and thereupon no further deposits shall be required to be made into the Debt Service Reserve Account. Prior to said transfer, all investments held in the Debt Service Reserve Account shall be liquidated to the extent necessary in order to provide for the timely payment of principal and interest (or Redemption Price) on Bonds.

6. Alternate Debt Service Reserve Account Deposits may be made for the benefit of the Owners of the Bonds as provided in this section E.6. In lieu of any required transfers of moneys to the Debt Service Reserve Account, the Department may cause to be deposited into the Debt Service Reserve Account for the benefit of the Owners of the Bonds an Alternate Debt Service Reserve Account Deposit in an aggregate amount equal to the difference between the Debt Service Reserve Requirement and the sums of moneys or value of Authorized Investments then on deposit in the Debt Service Reserve Account, if any. In lieu of retaining all or any portion of the moneys theretofore on deposit in the Debt Service Reserve Account, the Department may cause to be deposited into the Debt Service Reserve Account an Alternate Debt Service Reserve Account Deposit in an aggregate amount equal to such moneys, subject to section E.4 above. Each Alternate Debt Service Reserve Account Deposit shall be payable (upon the giving of notice as required thereunder) on any date on which moneys may be required to be withdrawn from the Debt Service Reserve Account and applied to the payment of a Principal Installment of or interest on any Bonds, or to reimburse any issuer of an Enhancement Facility constituting a Parity Obligation for any such payment made by such issuer, and such withdrawal cannot be met by amounts on deposit in the Debt Service Reserve Account. Any insurer providing an Alternate Debt Service Reserve Account Deposit surety bond or

insurance policy shall be an insurer whose municipal bond insurance policies insuring the payment, when due, of the principal of and interest on municipal bond issues results in such issues being rated in the highest Rating Category by at least one (1) Rating Agency. Any Alternate Debt Service Reserve Account Deposit letter of credit issuer shall be a bank or trust company which on the date of issuance of the letter of credit has an outstanding unsecured, uninsured and unguaranteed debt issue which is rated in the highest Rating Category by at least one (1) Rating Agency. Any provider of any other Alternate Debt Service Reserve Account Deposit obligation shall have the qualifications set forth in a Supplemental Indenture; *provided, however,* that prior to the deposit of such other Alternate Debt Service Reserve Account Deposit obligation in the Debt Service Reserve Account, the Trustee shall have received written confirmation from each Rating Agency to the effect that the deposit of such Alternate Debt Service Reserve Account Deposit will not, by itself, result in the withdrawal, suspension or downgrade of any rating issued by such Rating Agency with respect to any Outstanding Bonds. If a disbursement is made pursuant to an Alternate Debt Service Reserve Account Deposit, the Department shall either (i) reinstate the maximum limits of such Alternate Debt Service Reserve Account Deposit or (ii) deposit into the Debt Service Reserve Account funds in the amount of the disbursement made under such Alternate Debt Service Reserve Account Deposit, or a combination of such alternatives, at the times and in the amounts required by section E.3 above. In the event that the rating attributable to any provider of any Alternate Debt Service Reserve Account Deposit shall fall below that required as provided above, such Alternate Debt Service Reserve Account Deposit shall no longer be deemed to be an Alternate Debt Service Reserve Account Deposit and the Department shall either (i) replace such Alternate Debt Service Reserve Account Deposit with an Alternate Debt Service Reserve Account Deposit which shall meet the requirements provided above or (ii) deposit into the Debt Service Reserve Account sufficient funds, or a combination of such alternatives, at the times and in the amounts required by section E.3 above.

7. In the event of the refunding of any Bonds, the Trustee shall, upon the written direction of an Authorized Officer, withdraw from the Debt Service Reserve Account all or any portion of amounts accumulated therein with respect to the Bonds being refunded and apply such amounts in accordance with such direction; *provided, however,* that such withdrawal shall not be made unless (i) immediately thereafter the Bonds being refunded shall be deemed to have been paid pursuant to the Indenture, and (ii) subject to section E.5 above, the amount remaining in the Debt Service Reserve Account, after giving effect to any Alternate Debt Service Reserve Account Deposit, after such withdrawal shall not be less than the Debt Service Reserve Requirement.

F. Operating Reserve Account. 1. At the time any Series of Bonds is delivered pursuant to the Indenture, the Department shall pay into the Operating Reserve Account from the proceeds of such Bonds or other available funds, the amount, if any, necessary for the amount on deposit in the Operating Reserve Account to equal the Operating Reserve Account Requirement.

2. Amounts on deposit in the Operating Reserve Account shall be applied as provided in this Section F.

3. If at any time the amounts in the Operating Account shall be less than the then current requirements thereof for any payment, retention, accumulation, transfer or withdrawal required by sections A.1(a) through A.1(f) above, the Department shall withdraw from the Operating Reserve Account and deposit in the Operating Account the amounts necessary (or all the moneys in the Operating Reserve Account, if less than the amounts necessary), applying available amounts in the order of priority and otherwise as specified in sections A.1(a) through A.1(f) above to make up such deficiency; *provided, however,* that if and for so long as the balance on deposit in the Operating Reserve Account is equal to or less than the Priority Contract Contingency Reserve Amount, amounts in the Operating Reserve Account may only be withdrawn for deposit in the Priority Contract Account for the payment of Priority Contract Costs.

4. If at any time the amount on deposit in the Operating Reserve Account is less than the Operating Reserve Account Requirement, no later than the last Business Day of each calendar month the Department shall transfer from the Operating Account to the Operating Reserve Account pursuant to section A.1(i) above the amount, if any, required for the Operating Reserve Account to equal the Operating Reserve Account Requirement as of the last day of such calendar month; *provided, however,* that any deficiency in the Operating Reserve Account may be cured by depositing into the Operating Reserve Account each month during the period commencing no later than the seventh month following such determination of the deficiency, approximately equal or greater amounts such that the deficiency shall be cured by no later than the twelfth month following such determination of the deficiency.

5. The Department shall separately notify the Commission in writing each time the Operating Reserve Account Requirement is reduced pursuant to the Indenture. Whenever such reduction in the Operating Reserve Account Requirement occurs, any excess amounts in the Operating Reserve Account ("Excess Amounts") will be used at such time to

satisfy any deficiencies existing at such time in the transfers, applications and withdrawals required by sections A.1(a) through A.1(h) above, including repayment in full of the General Fund of the State for all advances made to the Department from amounts appropriated to the Electric Power Fund, whether before or after November 15, 2001, including interest payable thereon at the Pooled Money Investment Rate. Unless otherwise agreed by both the Department and the Commission, each acting in their own discretion, any Excess Amounts remaining after application to the uses described in the preceding sentence shall be used, at the direction of the Commission after consultation with the Department, to (i) adjust Department charges or (ii) with the agreement of the Department, reduce debt outstanding under the Indenture, in all instances upon consideration of, the interests of the retail customers of the Electrical Corporations and the Department, and, if applicable, Electric Service Provider retail customers.

6. If and when the Department no longer is responsible for the payment of costs under any Power Supply Contract, the entire balance, if any, on deposit in the Operating Reserve Account shall be applied as provided by section F.5 above.

G. Administrative Cost Account. Notwithstanding anything to the contrary in the Indenture, including but not limited to the provisions described in sections A, C and D above, all administrative costs of the Department incurred in administering Division 27 (commencing with Section 80000) of the Water Code, if and to the extent the payment thereof is subject to appropriation by the State Legislature pursuant to Section 80200(c) of the Water Code or other provision of law, shall be paid and accounted for through the Administrative Cost Account. Transfers shall be made from the Operating Account or, after the Department no longer is responsible for the payment of costs under any Power Supply Contract, the Operating Account or the Bond Charge Payment Account to the extent necessary to permit compliance with this section G.

Investment of Amounts in Accounts

Unless otherwise provided in a Supplemental Indenture, all amounts held in any fund, account or subaccount under the Indenture shall be invested by the Trustee in Authorized Investments. Unless otherwise determined by any Supplemental Indenture, earnings on moneys and investments in (i) the Operating Reserve Account shall be credited to and deposited in the Operating Account, and (ii) any other fund, account or subaccount under the Indenture shall be credited to and deposited in such fund, account or subaccount. Authorized Investments purchased as an investment of moneys in any such fund, account or subaccount shall be deemed at all times to be a part of such fund, account or subaccount, any profit realized from the liquidation of such investment shall be credited thereto and any loss resulting from the liquidation of such investment shall be charged thereto.

Revenue Requirements

The Department shall cause to be established, fixed and revised from time to time charges sufficient, together with any other available moneys and securities on deposit in the Electric Power Fund, to satisfy all of the Department's Revenue Requirements at the times and in the amounts needed. Without limiting the generality of the foregoing, such charges shall be sufficient, after taking into account any moneys and securities on deposit in the Operating Account, to produce Revenues sufficient in each calendar year: to pay all Operating Expenses in such calendar year as the same become due and payable; to pay the Interim Financing Notes and other amounts payable by the Department under the Credit and Security Agreement as the same become due and payable; to make all deposits to the Bond Charge Payment Account in the amounts and at the times required by section D under the caption "Application and Flow of Funds" above in such calendar year; to pay all Parity Obligations as and when the same become due and payable in such calendar year; to repay to the General Fund of the State advances made to the Department from amounts appropriated to the Electric Power Fund, and to repay General Fund moneys expended by the Department pursuant to the 2001 Emergency Measures, including interest thereon payable at the Pooled Money Investment Rate, at the times and in the amounts provided in the Indenture; to pay the debt service on all Subordinated Indebtedness then outstanding, and all Subordinated Obligations, as and when the same respectively become due and payable in such calendar year; to replenish the Debt Service Reserve Account as and to the extent required by section E under the caption "Application and Flow of Funds" above in the event of any deficiency therein; to replenish the Operating Reserve Account as and to the extent required by Section F under the caption "Application and Flow of Funds" above in the event of any deficiency therein; to retain on deposit in or make any deposit to any fund, account or subaccount pursuant to and to the extent necessary under the Act or required by any Financing Document, including, but not limited to, such retentions or deposits as shall be required to maintain the Minimum Operating Expense Available Balance as may be required by section A.5 under the caption "Application and Flow of Funds" above or to maintain reserves as may be required by clause (iv) of section A.1(j) under the caption "Application and Flow of Funds" above, and by clause (ii) of section C.1(d)

under the caption "Application and Flow of Funds" above; and to pay such other obligations of the Department, payable by the Department, in such calendar year as shall be incurred in accordance with both the Enabling Measures and the Indenture.

The Department will include in its Revenue Requirements amounts estimated to be sufficient:

(a) to cause the amount on deposit in the Operating Account (except any amounts set aside as reserves in subaccounts in the Operating Account for the purposes specified in clause (iv) of section A.1(j) under the caption "Application and Flow of Funds" above, at all times during any calendar month to equal the Minimum Operating Expense Available Balance;

(b) to cause the amount on deposit in the Bond Charge Collection Account, on the first Business Day of each calendar month, to equal the amounts projected to be required to be paid out of the Bond Charge Payment Account pursuant to section D.3 under the caption "Application and Flow of Funds" above in such calendar month, which projections shall be based on such assumptions, and which may take into account a range of possible outcomes, as the Department deems to be appropriate after consultation with the Commission, and

(c) for the payment of interest on Variable Rate Bonds during the relevant Revenue Requirement Period, assuming that interest accrues on such Variable Rate Bonds at a rate equal to the greater of (i) of 130% of the highest average interest rate in any calendar month during the twelve (12) calendar months, or such shorter period that such Variable Rate Bonds shall be Outstanding, ending with the month preceding the date such Revenue Requirements are filed with the Trustee or the Commission, as the case may be, or (ii) 4.0%.

For purposes of the covenant set forth in this paragraph, the Department may take into account the issuance of Bonds or other obligations anticipated to occur prior to the applicable Revenue Requirement Period.

No later than 90 days prior to the commencement of each calendar year beginning on and after January 1, 2003, the Department shall file with the Trustee an estimate of the Department's Revenue Requirements for such calendar year. The estimate for each calendar year shall demonstrate compliance with the requirements of this caption, and shall specify, on a monthly basis and in the aggregate for such calendar year, receipts of Revenues and deposits to, retentions in and transfers and withdrawals from the funds, accounts or subaccounts under the Indenture pursuant to sections A.1 and C under the caption "Application and Flow of Funds" above, including, but not limited to, withdrawals (i) for the payment of Priority Contract Costs and other Operating Expenses, principal and Redemption Price of and interest on Bonds, principal of and interest on the Interim Financing Notes and other amounts payable by the Department under the Credit and Security Agreement, Parity Obligations, Subordinated Obligations and Subordinated Indebtedness, taking into account any proceeds of Bonds or other amounts on deposit in the Operating Account, in the Priority Contract Account, in the Bond Charge Collection Account and in the Bond Charge Payment Account, (ii) to maintain the Debt Service Reserve Account and Operating Reserve Account in the amounts required by sections E and F under the caption "Application and Flow of Funds," respectively, and (iii) to repay to the General Fund of the State advances made to the Department from amounts appropriated to the Electric Power Fund, including interest thereon payable at the Pooled Money Investment Rate in accordance with the Act at the times and in the amounts provided in the Indenture.

Such estimates may be revised from time to time for any calendar year or for the balance of any then-current calendar year to reflect actual results and revised estimates; *provided, however,* that such estimates (i) shall be confirmed or revised in each calendar month during which the Department is permitted by the Act to enter into new contracts for the purchase of Power, and (ii) shall be revised as soon as practicable after the amount on deposit in any fund, account or subaccount under the Indenture shall be less than the amount required by the Indenture. Each confirmation or revision required by clause (i) of the foregoing proviso shall be filed with the Trustee as soon as practicable but no later than thirty (30) days (whether or not a Business Day) after the end of each calendar month to which it relates. Each confirmation or revision pursuant to this paragraph shall contain the same information required for the annual estimates by the foregoing paragraph.

Each such estimate and confirmation or revision thereof shall be accompanied by a written statement from a Consultant to the effect that the estimate or revision, as the case may be, reasonably can be expected to result in Revenues sufficient to satisfy the requirements of the Indenture or, if not, specifying the reasons therefor in reasonable detail.

The Department shall submit to the Commission such Revenue Requirements as shall be the subject of Rate Agreements, at such times and in such manner as the Department reasonably determines will enable the Commission to take action with respect thereto pursuant to the Rate Agreements to enable the Department to receive moneys in such amounts and at such times as shall permit the Department to fully comply with the provisions of the first two paragraphs under this caption. Without limiting the generality of the foregoing, the Department shall make projections, submit requests for changes in Revenue Requirements, Bond Charges and Power Charges, and take all other actions as are required of it under or pursuant to Section 4.1(b) and other provisions of the 2002 Rate Agreement, and by the provisions of any other Rate Agreement, to enable the Department to comply with the preceding sentence.

Rate Agreements

The Department shall enter into and maintain in effect at all times one or more Rate Agreements. Nothing contained in the Indenture shall (i) require the Department to continue to purchase or sell Power or (ii) prevent the Department from assigning, terminating or suspending any Power Supply Contract if (a) a Rate Agreement is in full force and effect, and (b) the Bond Charges established under the Rate Agreement are in full force and effect. The Department shall not voluntarily consent to or permit any amendment, termination or suspension, or waive any provision, of any Rate Agreement unless the Department shall determine, in a written determination signed by an Authorized Officer and delivered to the Trustee, that the same will not have a material adverse affect on the ability of the Department to comply with the provisions of the Indenture. The Department shall perform all of the obligations and conditions required to be performed and observed by it under each Rate Agreement, and shall take such actions from time to time as shall be necessary and available to enforce all of the obligations and conditions required to be performed and observed under each Rate Agreement by the Commission, in each case to the extent material to the payment of or security for the Bonds or Parity Obligations. An Authorized Officer shall promptly notify the Trustee and Co-Trustee in writing of any dispute or default, in each case if determined by the Department to be material to the payment of or security for the Bonds or Parity Obligations, and of each event of default, arising under any Rate Agreement as soon as practicable after the Department has actual knowledge thereof. If the Department shall have defaulted under its obligations contained in any Financing Document, such default is continuing and the Department has failed to enforce such Rate Agreement to the extent it is permitted to do so thereunder, the Co-Trustee shall have the right to enforce such Rate Agreements, as permitted by and subject to such Rate Agreements. All right, title and interest of the Department in, to and under each Rate Agreement is collaterally assigned to the Co-Trustee for the benefit of the Owners of Bonds and the holders or issuers of or other parties to Parity Obligations, to the extent necessary for purposes of such enforcement, subject to the terms of such Rate Agreements. The Co-Trustee agrees to comply with all provisions of any Rate Agreement necessary to enable it to exercise the rights granted by the Indenture and described in this paragraph.

Cooperation with Commission

Wherever the Indenture requires the Department to consult with the Commission with respect to assumptions made by the Department, the Department shall involve the Commission in the development of these assumptions by conferring regularly in a manner consistent with the Department's obligations under the 2002 Rate Agreement.

Servicing Arrangements; Collection of Revenues

The Department shall enter into and maintain in effect at all times one or more Servicing Agreements which, in aggregate, shall provide for all of the following functions and services: transmit or provide for the transmission of, and distribute, all Power; billing, collection and remittance of all moneys constituting Bond Charges, Power Charges, Direct Access Power Charges or other charges; and all other services related to the foregoing; *provided, however,* that separate Servicing Agreements may be entered into and maintained for separate functions and services; and provided further, however, that no Servicing Agreement shall be required for any functions or services to the extent such functions or services are performed directly by the Department, subject to the following sentence, or pursuant to an order ("Servicing Order") of the Commission. The Department shall not attempt to assert any authority to perform any such function or service except as permitted under an applicable Servicing Agreement or Servicing Order. The Department shall request such Servicing Orders of the Commission as the Department determines to be necessary or appropriate in connection with the performance of such functions or services and the implementation or enforcement of any Servicing Agreement.

The Department shall not voluntarily consent to or permit any amendment, termination or suspension, or waive any provision, of any Servicing Arrangement unless the Department determines, in a written determination signed by an Authorized Officer and delivered to the Trustee, that the same will not have a material adverse affect on the ability of the Department to comply with the provisions of the Indenture. The Department shall perform and observe all of the obligations

and conditions required to be performed and observed by it under each Servicing Arrangement, and shall take such actions from time to time as shall be necessary and available to enforce all of the obligations and conditions required to be performed and observed under each Servicing Agreement by the other party thereto, and to enforce each Servicing Order in accordance with its terms, in each case to the extent material to the payment of and security for the Bonds or Parity Obligations.

If an Event of Default shall have occurred and be continuing, the Co-Trustee shall have the right to enforce the Servicing Arrangements to the extent the Department fails to do so, as permitted by and subject to such Servicing Arrangements. All right, title and interest of the Department in, to and under the Servicing Arrangements is hereby collaterally assigned to the Co-Trustee for the benefit of the Owners of Bonds, the holders of Interim Financing Notes and the holders or issuers of or other parties to Parity Obligations, to the extent necessary for purposes of such enforcement, subject to the terms of such Servicing Arrangements. If the Department shall have defaulted under its obligations contained in any Financing Document and such default is continuing, the Co-Trustee shall have the right to request Servicing Orders with respect to the Servicing Agreements or the functions and services described above, and to request the Commission to enforce the same, to the extent the Department fails to do so. All right, title and interest of the Department in, to and under the Servicing Arrangements, insofar as it relates to such requests and enforcement, is hereby collaterally assigned to the Co Trustee for the benefit of the Owners of Bonds, the holders of Interim Financing Notes and the holders or issuers of or other parties to Parity Obligations, to the extent necessary for purposes of such requests and enforcement, subject to the terms of such Servicing Arrangements. The Co-Trustee agrees to comply with all provisions of any Servicing Arrangements necessary to enable it to exercise the rights described above, and in doing so shall be subject to the provisions of the Indenture.

The Department shall use its best efforts to collect or cause to be collected all moneys due and payable to the Department, which, upon receipt by the Department, would constitute Revenues, as soon as practicable after the same are due and payable; *provided, however,* that nothing contained in the Indenture shall prohibit the effectuation of the program provided by Executive Order No. D-56-02 dated May 23, 2002, including the financing thereof, as provided thereby.

All right, title and interest of the Department in, to and under the Servicing Arrangements to amounts payable, and payments, to the Department pursuant to and under the Servicing Arrangements are hereby collaterally assigned to the Trustee and Co-Trustee for the benefit of the Owners of the Bonds, the holders of Interim Financing Notes and the holders or issuers of or other parties to Parity Obligations, subject to the terms of such Servicing Arrangements.

Non-Impairment Covenant of State; Extension of Sunset Date

Under the Indenture, the State pledges and undertakes that while any obligations of the Department incurred under Division 27 of the State Water Code, including without limitation the Indenture, the Bonds and Parity Obligations, remain outstanding and not fully performed or discharged, the rights, powers, duties, and existence of the Department and the Commission shall not be diminished or impaired in any manner that will affect adversely the interests and rights of the holders of or parties to such obligations. This pledge and undertaking is included in the Indenture pursuant to the authority to do so contained in Section 80200(e) of the State Water Code.

Any extension of the January 1, 2003, termination date for the authority of the Department to contract for the purchase of Power, contained in Section 80260 of the State Water Code, shall not constitute a violation of the foregoing pledge and undertaking of the State, nor shall any such extension constitute a violation of or default under the Indenture.

Covenant Relating to Retirement of Bonds

The Department shall schedule the maturity of, redeem or otherwise retire Bonds in accordance with the Indenture at such times and in such amounts as are necessary to assure that the Department complies with Paragraph II of the Summary of Material Terms referred to in Section 7.10 of the Rate Agreement, as such Summary of Material Terms was amended by Paragraph 18 of the Amended and Restated Addendum to Summary of Material Terms of Financing Documents dated as of August 8, 2002. Such provisions require, in part, that the plan of finance of the Bonds provide for substantially level debt service.

Continuing Disclosure

The Department has covenanted in the Indenture to post on its website, so long as it maintains a website, (i) within forty-five (45) days of the end of each fiscal year quarter except the fourth quarter, unaudited financial statements of the

Department relating to its Electric Power Fund for such quarter, (ii) within one hundred twenty (120) days after the end of each fiscal year, audited financial statements of the Department relating to its Electric Power Fund for such fiscal year, and (iii) promptly, each Revenue Requirement filing made by the Department with the Commission. The Department shall send notice of each such posting, by first class mail, to any Person filing with the Chief, Division of Fiscal Services, or the Chief, Financial Management Office, Power Supply Program of the Department a written request therefor, to the address specified by such Person. If the Department no longer maintains a website, the Department will send such documents by first class mail to any Person filing with the Chief, Division of Fiscal Services, or Chief, Financial Management Office, Power Supply Program, a written request therefor, to the address specified by such Person.

In the event of a failure of the Department to comply with any provision of this covenant, the Trustee may (and, at the request of the Owners of at least 50% in aggregate principal amount of Outstanding Bonds, shall), or any Owner or Beneficial Owner of the Bonds may (unless the Department has so complied within 20 days after written notice from the Trustee, such Owner or Owners, or such Beneficial Owner or Beneficial Owners, as the case may be, of the Department's failure to comply) seek specific performance by court order, to cause the Department to comply with its obligations under this covenant, as the sole remedy, and default under this covenant shall not be deemed a default or an Event of Default under the Indenture, notwithstanding anything in the Indenture to the contrary. For this purpose, "Beneficial Owner means any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds (including persons holding Bonds through nominees, depositories and other intermediaries).

Supplemental Indentures and Amendments

The Department, the Trustee and the Co-Trustee may adopt (without the consent of or notice to any Owner) Supplemental Indentures to, among other purposes, prohibit, or provide limitations and restrictions in addition to the limitations and restrictions contained in the Indenture on, the delivery on original issuance of Bonds or the issuance of other evidences of indebtedness; add to the covenants and agreements of the Department in the Indenture other covenants and agreements to be observed by the Department which are not contrary to or inconsistent with the Indenture as theretofore in effect; add to the limitations and restrictions in the Indenture other limitations and restrictions to be observed by the Department which are not contrary to or inconsistent with the Indenture as theretofore in effect; surrender any right, power or privilege reserved to or conferred upon the Department by the Indenture; authorize Bonds of a Series or to amend, modify or rescind any such authorization, specification or determination at any time prior to the first delivery of such Bonds; authorize Subordinated Indebtedness and provide with respect thereto to the extent provided by, and otherwise not inconsistent with, the Indenture theretofore in effect; subject Subordinated Obligations and Subordinated Indebtedness to the lien on and pledge of the Trust Estate pursuant to the Indenture on a subordinate basis; confirm, as further assurance, any pledge under, and the subjection to any lien or pledge created or to be created by, the Indenture, of any additional security other than that previously granted or pledged under the Indenture; modify, amend or supplement the Indenture in such manner as to permit the qualification of the Indenture under the Trust Indenture Act of 1939, as amended, or any similar Federal statute hereafter in effect or to permit the qualification of the Bonds for sale under the securities laws of any of the states of the United States of America, and, if the Department so determines, to add to the Indenture such other terms, conditions and provisions as may be permitted by said Trust Indenture Act of 1939 or similar Federal statute; comply with regulations and procedures as are from time to time in effect relating to any book-entry-only system, whether within or without the United States, for the registration of beneficial ownership interests in Bonds; to evidence the assignment and transfer of rights, and the delegation of duties and obligations, of the Department by operation of law to another department, agency or instrumentality of the State that has indicated in writing its willingness to accept the rights of the Department and to assume and discharge the duties and obligations of the Department; modify any of the provisions of the Indenture in any other respect whatever with respect to any Bonds, provided that (i) (a) such modification relates only, and is to be effective prior to the issuance of, such Bonds, or (b) such modification relates only, and is to be effective only upon the remarketing of, such Bonds in connection with an optional or mandatory tender thereof for purchase by or on behalf of the Department, and (ii) such modification is disclosed in an offering or reoffering document applicable to such issuance or remarketing; or modify any of the provisions of the Indenture in any other respect whatever, provided that such modification shall be, and shall be expressed to be, effective only after all Bonds Outstanding, outstanding Interim Financing Notes and outstanding or unpaid Parity Obligations at the date of the execution and delivery of such Supplemental Indenture shall cease to be Outstanding or owing, as the case may be.

For any one or more of the following purposes and at any time or from time to time, a Supplemental Indenture may be executed by the Department, the Trustee and the Co-Trustee without the consent of or notice to any Owner, which, upon delivery to the other parties thereto and the satisfaction of the requirements of the Indenture, shall be effective in accordance with its terms: (1) to cure any ambiguity, supply any omission, or cure or correct any defect or inconsistent provision in the Indenture; or (2) to insert such provisions, or to make such other amendments to the Indenture, as are necessary or desirable

which are not materially adverse to the rights under the Indenture of the Owners of Bonds, the holders of Interim Financing Notes and the holders or issuers of or other parties to Parity Obligations.

Any modification or amendment of the Indenture and of the rights and obligations of the Department and of the Owners, in any particular, may be made by a Supplemental Indenture, with the written consent given as provided in the Indenture (i) of the Owners of a majority in principal amount of the Bonds Outstanding at the time such consent is given, and (ii) in case less than all of the Bonds then Outstanding are affected by the modification or amendment, of the Owners of a majority in principal amount of the Bonds so affected and Outstanding at the time such consent is given; *provided, however,* that if such modification or amendment will, by its terms, not take effect so long as particular Bonds remain Outstanding, the consent of the Owners of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds under this caption. No such modification or amendment shall (a) permit a change in the terms of redemption or maturity of the principal of any Outstanding Bond or of any installment of interest thereon or a reduction in the principal amount or the Redemption Price thereof or in the rate of interest thereon without the consent of the Owner of such Bond, (b) reduce the percentages or otherwise affect the classes of Bonds the consent of the Owners of which is required to waive an Event of Default or otherwise effect any such modification or amendment, (c) create a preference or priority of any Bond or Bonds over any other Bond or Bonds, without the consent of the Owners of all such Bonds, (d) create a lien prior to or on parity with the lien of the Indenture, without the consent of the Owners of all of the Bonds then Outstanding, except to the extent permitted by the Indenture, or (e) change or modify any of the rights or obligations of any Fiduciary without its written assent thereto. For the purposes of this paragraph, a Bond shall be deemed to be affected by a modification or amendment of the Indenture if the same materially and adversely affects the rights of the Owner of such Bond. The Trustee may in its discretion determine whether or not in accordance with the foregoing powers of amendment particular Bonds would be affected by any modification or amendment of the Indenture and any such determination shall be binding and conclusive on the Department and all Owners of Bonds.

The terms and provisions of the Indenture and the rights and obligations of the Department and of the Owners of Bonds may be modified or amended in any respect upon the execution by the Department, the Trustee and the Co-Trustee of a Supplemental Indenture, the filing of a fully executed copy with the Trustee and the Co-Trustee, and the consent of the Owners of all of the Bonds then Outstanding, such consent to be given as provided in the Indenture; *provided, however,* that no such modification or amendment shall change or modify any of the rights or obligations of any Fiduciary without the filing with the Trustee of the written assent thereto of such Fiduciary in addition to the consent of the Owners of Bonds.

Events of Default and Remedies

Pursuant to the Indenture, any one or more of the following events shall constitute "Events of Default": (1) if default shall be made in the due and punctual payment of the principal or Redemption Price of any Bond, or in the due and punctual payment of the principal or redemption price, if any, of any Parity Obligation when and as the same shall become due and payable, whether at maturity or by call for redemption, or otherwise; (2) if default shall be made in the due and punctual payment of any installment of interest on any Bond or of interest, if any, on any Parity Obligation when and as such interest installment shall become due and payable, and such default shall continue for a period of 5 days; (3) if the Department defaults in the performance or observance on its part of any of the covenants or agreements contained in the Indenture relating to the submission by the Department of Revenue Requirements to the Commission, relating to the Rate Agreements or relating to the Servicing Arrangements, and such default shall continue for a period of 10 days after written notice thereof to the Department by the Trustee or the Co-Trustee, or to the Department, the Trustee and the Co-Trustee by the Owners of a majority in principal amount of the Bonds Outstanding; *provided, however,* that no such default relating to submission by the Department of Revenue Requirements to the Commission shall constitute an Event of Default if and for so long as the Commission is taking action to cure the Department's default pursuant to Section 4.1(a) of the 2002 Rate Agreement or otherwise; (4) if an "event of default," as defined in any Rate Agreement, on the part of the Commission shall have occurred and be continuing; (5) if any "event of default," as defined in the Credit and Security Agreement or any Parity Obligation, on the part of the Department shall have occurred and be continuing; (6) if the Department defaults in the performance or observance on its part of any other of the covenants or agreements contained in the Indenture or in the Bonds to be performed, other than as specified in clauses (1) through (3) above, and such default shall continue for a period of 60 days after written notice thereof to the Department by the Trustee or Co-Trustee, or to the Department, the Trustee and the Co-Trustee by the Owners of a majority in principal amount of the Bonds Outstanding; *provided, however,* that if such default shall be such that it cannot be remedied by the Department within such 60 day period, it shall not constitute an Event of Default if corrective action is instituted by the Department within such period and diligently pursued by the Department until the default is remedied; or (7) with respect to a Series of Bonds, any additional events as may be specified in the Supplemental Indenture authorizing the issuance of such Series.

Anything in the Indenture to the contrary notwithstanding, neither the Trustee nor the Co-Trustee nor the Owners nor the issuer of any Enhancement Facility nor a party to any Swap Obligation shall have the right to accelerate the maturity of any Bond or Parity Obligation. The preceding sentence shall not be construed to prohibit any redemption of Bonds or Parity Obligations at the option of the Owner, holder or issuer thereof or other party thereto, or if required pursuant to any Enhancement Facility, or any optional or mandatory tender of Bonds or Parity Obligations pursuant to the terms thereof, or any early termination of a Qualified Swap (subject to the Indenture).

During the continuance of an Event of Default, the Trustee shall take control of the Operating Account, the Priority Contract Account, the Operating Reserve Account and the Administrative Cost Account and apply all amounts on deposit therein, Revenues and the income therefrom to payments as follows and in the following order:

(i) The reasonable and proper charges and expenses of the Trustee and the Co-Trustee (including, but not limited to, reasonable legal fees and expenses and charges and expenses of any management consultant or consulting engineer, or firm of either thereof, selected by the Trustee or Co-Trustee pursuant to paragraph (ii) below. Such charges and expenses shall only be paid from Power Charge Revenues or Bond Charge Revenues.

(ii) The amounts required for reasonable and necessary Operating Expenses, including, but not limited to, reasonable and necessary reserves and working capital. The Trustee or the Co-Trustee may retain a management consultant or consulting engineer, or firm of either thereof, of recognized standing (who may be an engineer or management consultant, or firm of either thereof, retained by the Department for other purposes) for the purpose of rendering advice with respect to such matters. For this purpose the books of record and account of the Department shall at all times be subject to the inspection of such consultant, engineer or firm of consultants or engineers during the continuance of such Event of Default.

(iii) The interest and principal or Redemption Price then due on the Bonds, and the interest and principal components of Parity Obligations (which, in the case of Swap Obligations shall consist of scheduled payments and termination payments, respectively) as follows:

> **First:** To the payment to the Persons entitled thereto of all installments of interest then due on the Bonds and the interest component of Parity Obligations, in the order of the maturity of such installments, and, if the amount available shall not be sufficient to pay in full any installment or installments maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon, to the Persons entitled thereto, without any discrimination or preference; and
>
> **Second:** To the payment to the Persons entitled thereto of the unpaid principal or Redemption Price of any Bonds and the unpaid principal component of Parity Obligations, which shall have become due, whether at maturity or by call for redemption, in the order of their due dates, and, if the amount available shall not be sufficient to pay in full all the Bonds and the principal component of Parity Obligations, due on any date, then to the payment thereof ratably, according to the amounts of principal or Redemption Price due on such date, to the Persons entitled thereto, without any discrimination or preference.

If and whenever all overdue installments of interest on all Bonds and Parity Obligations, together with the reasonable and proper charges and expenses of the Trustee and the Co-Trustee, and all other sums payable by the Department under the Indenture, including, but not limited to, the principal and Redemption Price of and accrued unpaid interest on all Bonds and Parity Obligations which shall then be payable, shall either be paid by or for the account of the Department, or provision satisfactory to the Trustee and the Co-Trustee shall be made for such payment, and all defaults under the Indenture or the Bonds, the Credit and Security Agreement and all agreements, instruments or notes evidencing Parity Obligations shall be made good or secured to the satisfaction of the Trustee and the Co-Trustee or provision deemed by the Trustee and the Co-Trustee to be adequate shall be made therefor, all Revenues shall thereafter be applied as provided under the caption "Application and Flow of Funds" above, and the Trustee shall return control of the Operating Account, the Priority Contract Account, the Operating Reserve Account, the Bond Charge Collection Account and the Administrative Cost Account to the Department. No such resumption of the application of Revenues as provided under the caption "Application and Flow of Funds" above shall extend to or affect any subsequent default under the Indenture, the Credit and Security Agreement and all agreements, instruments or notes evidencing Parity Obligations, or impair any right consequent thereon.

If (i) an Event of Default shall happen and shall not have been remedied, and (ii) whether or not an Event of Default has happened or shall have been remedied, in the event of any failure of the Department to pay into the Operating Account, as and when received, Power Charge Revenues as described under Section A under the caption "Application and Flow of Funds" above or to pay into the Bond Charge Collection Account, as and when received, Bond Charge Revenues, as described under section C under the caption "Application and Flow of Funds" above, or to collect or cause to be collected Revenues as required by the Indenture, or in the event of a violation of the pledge and agreement of the State in the Indenture, then and in every such case, the Co-Trustee, by its agents and attorneys, if the Co-Trustee shall deem it advisable, may proceed to protect and enforce its rights and the rights of the Owners of Bonds and the holders or issuers of or other parties to Parity Obligations under the Indenture forthwith by a suit or suits in equity or at law, whether for the specific performance of any covenant contained in the Indenture, or in aid of the execution of any power granted in the Indenture, or for an accounting against the Department as if the Department were the trustee of an express trust, or in the enforcement of any other legal or equitable right as the Co-Trustee, being advised by counsel, shall deem most effectual to enforce any of its rights or to perform any of its duties under the Indenture. Notwithstanding the occurrence of an Event of Default, the Co-Trustee shall have only such rights to enforce the Rate Agreements as are set forth in such Rate Agreements.

No Owner shall have any right to institute any suit, action or proceeding at law or in equity for the enforcement of any provision of the Indenture or the execution of any trust under the Indenture or for any remedy under the Indenture, unless such Owner shall have previously given to the Trustee and the Co-Trustee written notice of the happening of an Event of Default, and the Owners of at least twenty-five percent (25%) in principal amount of the Bonds then Outstanding shall have filed a written request with the Trustee and the Co-Trustee, and shall have offered the Co-Trustee reasonable opportunity, either to exercise the powers granted as described under this caption or to institute such action, suit or proceeding in its own name, and unless such Owners shall have offered to the Co-Trustee adequate security and indemnity against the costs, expenses and liabilities to be incurred therein or thereby, and the Co-Trustee shall have refused to comply with such request within a reasonable time; it being understood and intended that no one or more Owners of Bonds shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the pledge created by the Indenture, or to enforce any right under the Indenture, except in the manner therein provided; and that all proceedings at law or in equity to enforce any provision of the Indenture shall be instituted, had and maintained in the manner provided in the Indenture and for the equal benefit of all Owners of the Outstanding Bonds.

Resignation and Removal of Co-Trustee

The Co-Trustee may at any time resign and be discharged of the duties and obligations created by the Indenture by giving not less than 90 days' written notice to the Department and the Trustee, and the Trustee thereupon shall mail notice thereof to the Owners of the Bonds, specifying the date when such resignation shall take effect, at least 30 days prior to the effective date, provided that such resignation shall take effect upon the later of (i) the day specified in such notice and (ii) the day a successor shall have been appointed by the Department or the Owners of Bonds as provided in the Indenture.

The Co-Trustee may be removed at any time by an instrument or concurrent instruments in writing, filed with the Trustee and the Co-Trustee, and signed by the Owners of a majority in principal amount of the Bonds then Outstanding or their attorneys-in-fact duly authorized, excluding any Bonds held by or for the account of the Department; *provided, however,* that the Co-Trustee may be removed only for cause unless and until an Event of Default shall have occurred and be continuing under the Indenture. In addition, so long as no Event of Default shall have occurred and be continuing under the Indenture and the Co-Trustee is not pursuing any right or remedy available to it pursuant to the Indenture, the Co-Trustee may be removed by the Department at any time for failure to provide reasonably acceptable services, failure to charge reasonably acceptable fees or any other reasonable cause, all as determined by a written determination signed by an Authorized Officer and filed with the Trustee and the Co-Trustee, which determination shall be conclusive. Any such removal shall not be effective until a successor shall have been appointed by the Department or the Owners of Bonds as provided in the Indenture.

Defeasance

If the Department shall pay or cause to be paid to the Owners of all Bonds then Outstanding the principal or Redemption Price, if any, and interest to become due thereon, to the other parties to the Credit and Security Agreement all amounts payable thereunder, and to the holders or issuers of or other parties to all Parity Obligations all amounts payable thereunder and upon the termination thereof, at the times and in the manner stipulated therein and in the Indenture, then the covenants, agreements and other obligations of the Department to the Owners of Bonds, the other parties to the Credit and Security Agreement, and the holders or issuers of or other parties to all Parity Obligations shall be discharged and satisfied.

In such event, the Trustee shall, upon the request of the Department, execute and deliver to the Department all such instruments as may be desirable to evidence such discharge and satisfaction and the Fiduciaries shall pay over or deliver to the Department all money, securities and funds held by them pursuant to the Indenture which are not required for the payment or redemption of Bonds not theretofore surrendered for such payment or redemption, or required to make payments under the Credit and Security Agreement and Parity Obligations.

Outstanding Bonds or any portion thereof shall, prior to the maturity or redemption date thereof, be deemed to have been paid within the meaning and with the effect expressed in the Indenture either (A) as provided in the Supplemental Indenture authorizing their issuance or (B) if (a) in case any of said Bonds are to be redeemed on any date prior to their maturity, the Department shall have given to the Trustee, in form satisfactory to it irrevocable instructions to mail, as provided in the Indenture notice of redemption on said date of such Bonds, (b) there shall have been irrevocably deposited with the Trustee or other Paying Agent either moneys in an amount which shall be sufficient, or Defeasance Securities the principal of and the interest on which when due will provide moneys which, together with the moneys, if any, deposited with the Trustee or such Paying Agent at the same time, shall be sufficient, without further investment or reinvestment of either the principal amount thereof or the interest earnings thereon, to pay when due, the principal or Redemption Price, if applicable, and interest due and to become due on such Bonds on and prior to the redemption date or maturity date thereof, as the case may be, (c) in the event such Bonds are not by their terms maturing or are not to be redeemed within the next succeeding 60 days, the Department shall have given the Trustee in form satisfactory to it irrevocable instructions to mail, as soon as practicable, a notice to the Owners of such Bonds that the deposit required by clause (b) above has been made with the Trustee and that said Bonds are deemed to have been paid as described under this caption and stating such maturity or redemption date upon which moneys are to be available for the payment of the principal or Redemption Price, if applicable, on such Bonds, and (d) in the case of Bonds subject to optional or mandatory tender for purchase prior to the maturity or earlier redemption date specified for its payment pursuant to this paragraph, the Trustee or such Paying Agent shall have received written confirmation from each Rating Agency to the effect that the deposit and provisions for defeasance made pursuant to this paragraph will not, by themselves, result in the withdrawal, suspension or downgrade of any rating issued by such Rating Agency with respect to such Bonds. Neither Defeasance Securities nor moneys deposited with the Trustee or other Paying Agent as described under this caption nor principal or interest payments on any such Defeasance Securities shall be withdrawn or used for any purpose other than, and shall be held in trust for, the payment of the principal or Redemption Price, if applicable, and interest on said Bonds; *provided, however,* that any moneys on deposit with the Trustee or such Paying Agent, (i) to the extent such moneys will not be required at any time for such purpose, shall be deposited in the Bond Charge Collection Account or, if the first paragraph of this caption applies, paid over to the Department as received by the Trustee or such Paying Agent, free and clear of any trust, lien or pledge securing said Bonds or otherwise existing under the Indenture, and (ii) to the extent such moneys will be required for such purpose on another date, shall, to the extent practicable, be reinvested in Defeasance Securities maturing at times and in amounts sufficient, together with any moneys available to the Trustee or Paying Agent for such purpose, to pay when due the principal or Redemption Price, if applicable, and interest to become due on said Bonds on and prior to the redemption date or maturity date thereof, as the case may be. Notwithstanding ay other provision of the Indenture, the Department may, at the time any Bonds are deemed to have been paid within the meaning and with the effect as set forth above, elect to retain the right to redeem or require the tender of any such Bonds; *provided, however,* that such Bonds shall at all times comply with the requirements described above for such Bonds to be deemed to have been paid as aforesaid.

Anything in the Indenture to the contrary notwithstanding, all instructions by the Department, accepted by the Trustee or any Paying Agent, given pursuant to the Indenture to mail notice of redemption of the Bonds of a Series (other than Bonds of such Series which have been purchased by the Trustee at the direction of the Department as therein provided prior to the mailing of such notice of redemption) shall be irrevocable and shall foreclose the exercise by the Department of any other optional redemption right with respect to such Bonds, except that any such instructions may be. revoked prior to any deposit pursuant to the Indenture.

Unclaimed Moneys

The amounts held by any Fiduciary for the payment of the interest, principal or Redemption Price due on any date with respect to particular Bonds or any amount payable under the Credit and Security Agreement or Parity Obligations shall, on and after such date and pending such payment, be set aside on its books and held in trust by it for the Owners of Bonds, the other parties to the Credit and Security Agreement or the holders or issuers of or other parties to Parity Obligations entitled thereto. Anything in the Indenture to the contrary notwithstanding, any moneys so held by the Fiduciary, which remain unclaimed for two (2) years after the date when such principal, Redemption Price, interest or amounts, respectively, became due and payable, either at their stated maturity or due dates or by call for earlier redemption, if such moneys were held by the Fiduciary at such date, or for two (2) years after the date of deposit of such moneys if deposited with the

Fiduciary after the date when such principal, Redemption Price, interest or amounts, respectively, became due and payable, shall, at the written request of the Department, be repaid by the Fiduciary to the Department or such officer, board or body as then may be entitled by law to receive the same, as its absolute property and free from trust, and the Fiduciary shall thereupon be released and discharged with respect thereto and the Owners of Bonds, the other parties to the Credit and Security Agreement and the holders or issuers of or other parties to Parity Obligations, as applicable, shall look only to the Department or such officer, board or body for the payment of such principal, Redemption Price, interest or amounts, respectively. Before being required to make any such payment to the Department, the Fiduciary shall, at the expense of the Department, cause to be mailed to the Owners, holders, issuers or parties entitled to receive such moneys, at their last addresses, if any, appearing upon the registry books or other notice addresses on file with the Fiduciary or the Department, a notice that said moneys remain unclaimed and that, after a date named in said notice, which date shall be not less than 30 days after the date of the mailing, the balance of such moneys then unclaimed will be returned to the Department or such officer, board or body. The failure of any Owner of Bonds, holders, issuers or parties to receive such notice shall not affect the application of moneys as described under this caption.

Successors and Assigns

Whenever in the Indenture, the Bonds, the Credit and Security Agreement, any agreement, instrument or note evidencing a Parity Obligation, Subordinated Indebtedness, Subordinated Obligation, or any other obligation of the Department under or pursuant to the Indenture, the Department is named or referred to, it shall be deemed to include its successors and assigns and all the covenants and agreements in the Indenture or in the Bonds or such other obligations contained by or on behalf of the Department shall bind and inure to the benefit of its successors and assigns whether so expressed or not; *provided, however,* that such successor or assign is permitted by law to assume the Department's obligations thereunder and shall agree to be bound by the terms thereof.

Governing Law and Venue

The Indenture shall be governed by and interpreted in accordance with internal laws of the State without regard to conflicts of law principles. All legal actions and proceedings arising from the Indenture or the Bonds shall be brought in the courts of the State located in the County of Sacramento, except as otherwise may be expressly agreed to by the Department. The parties to the Indenture, and the Owners by their acceptance of Bonds, consent to and accept for themselves and in respect of their property, generally and unconditionally, the jurisdiction of the aforesaid courts, and to the extent permitted by law, irrevocably waive any objection, including, without limitation, any objection to the laying of venue or based on the grounds of forum non conveniens, which they may now or hereafter have to the bringing of any such action or proceeding in such respective jurisdictions, except as otherwise may be agreed to in writing by the Department, the Trustee and the Co-Trustee.

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APPENDIX D

RATE AGREEMENT

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APPENDIX D

RATE AGREEMENT

By and Between

STATE OF CALIFORNIA DEPARTMENT OF WATER RESOURCES

and

STATE OF CALIFORNIA PUBLIC UTILITIES COMMISSION

Dated as of March 8, 2002

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RATE AGREEMENT, dated as of March 8, 2002, by and between **STATE OF CALIFORNIA DEPARTMENT OF WATER RESOURCES** and **STATE OF CALIFORNIA PUBLIC UTILITIES COMMISSION.**

The parties mutually agree as follows:

ARTICLE I
DEFINITIONS

Section 1.1 Definitions. The terms set forth in this Section shall have the meanings ascribed to them herein for all purposes of this Agreement unless the context clearly requires otherwise. Words in the singular shall include the plural and words in the plural shall include the singular where the context so requires.

"Act" shall mean Chapter 4 of the Statutes of 2001 (AB 1 of the First 2001-02 Extraordinary Session) of the State, as amended from time to time.

"Agreement" shall mean this Rate Agreement, as from time to time hereafter amended or supplemented in accordance with the provisions hereof.

"Beneficiaries" shall mean, at any given time, the persons to whom the Department is then obligated to pay Bond Related Costs described in clauses (i) through (iv) of the definition of such term, in each case solely to the extent of such obligations.

"Bond Charge" shall mean a charge imposed by the Commission, by order promulgated as a result of this Agreement, upon customers in each of the Service Areas of Pacific Gas & Electric, Southern California Edison Company and San Diego Gas & Electric Company or any of their respective successors based on the aggregate amount of electric power sold to that customer by an Electrical Corporation and the Department, and to the extent determined under Section 4.3 hereof, by an Electric Service Provider, such charge to be revised from time to time by the Commission in such a manner that amounts on deposit in the Bond Charge Payment Account as a result of the charge are always sufficient to pay or provide for the payment of the Bond Related Costs; provided, that Bond Charges shall be imposed upon such customers in each Service Area at all times required by this Agreement whether or not the Department is at the time selling, or deemed to be selling, Power to such customers until such time as the Department has recovered the portion of the Department's revenue requirements under Section 80134 of the Act constituting Bond Related Costs.

"Bond Charge Collection Account" shall have the meaning set forth in the Financing Documents. Revenues that the Department receives from Bond Charges shall be deposited in the Bond Charge Collection Account.

"Bond Charge Payment Account" shall have the meaning set forth in the Financing Documents. The primary purpose of the Bond Charge Payment Account is to hold amounts that the Financing Documents require to be periodically transferred from the Bond Charge Collection Account to provide for the payment of Bond Related Costs.

"Bond Related Costs" shall mean payments of, or deposits or other provision to be made by the Department under Financing Documents or the Act for the following components of the Department's revenue requirements under Section 80134 of the Act:

(i) principal of, premium, if any, and interest on Bonds and any additional amount required under the Financing Documents to be deposited into the Bond Charge Collection Account to provide debt service coverage of the Bonds;

(ii) payments required to be made (A) under agreements with issuers of credit and liquidity facilities and their participants, including but not limited to, letters of credit, bond insurance, guarantees, debt service reserve fund surety bonds, lines of credit, reimbursement agreements, and standby bond purchase agreements, (B) under agreements relating to other financial instruments entered into in connection with the Bonds, including but not limited to investment agreements, hedges, interest rate swaps, caps, options and forward purchase agreements and (C) under agreements relating to the remarketing of Bonds, including but not limited to remarketing agreements, dealer agreements and auction agent agreements;

(iii) deposits to the Debt Service Reserve Account established under the Financing Documents to the extent necessary to provide therein an amount equal to the requirement for such account under the Financing Documents if not otherwise replenished from Power Charges;

(iv) the cost of Fiduciaries associated with the issuance and administration of the Bonds; and

(v) when and if the Department no longer sells Power under the Act and Bonds remain outstanding, the Department's Bond Charge servicing costs, costs of preparing and providing the information and reports required under the Financing Documents, this Agreement and the Act, related audit, legal and consulting costs, related administrative costs, and costs of complying with arbitrage restrictions and rebate requirements.

"Bonds" shall mean State of California Department of Water Resources evidences of indebtedness issued for the purposes specified in the Act pursuant to Section 80130 of the Act and the Executive Order of the Governor of the State of California, dated June 18, 2001, in an aggregate principal amount up to $ 13,423,000,000; provided, however, that (i) notes issued in anticipation of the issuance of Bonds and retired from the proceeds of those Bonds shall not be counted against said dollar limitation, and (ii) Bonds shall include indebtedness issued to refund prior Bonds, but such refunding indebtedness

shall not be counted against said dollar limitation; and, provided, further that, for all purposes of this definition, the Bonds shall exclude the Interim Loan.

"Commission" shall mean the State of California Public Utilities Commission and any board, commission, department, corporation, authority or officer succeeding to the functions thereof, or to whom the powers conferred on the Commission by the Act shall be given by law.

"Debt Service Reserve Account" shall have the meaning set forth in the Financing Documents. The purpose of the Debt Service Reserve Account is to provide for the payment of Bond Related Costs in the event that amounts in the Bond Charge Payment Account, after deposits from the Bond Charge Collection Account or other funds under the Indenture, are insufficient. The Debt Service Reserve Account is expected to be initially funded with Bond proceeds.

"Department" shall mean the State of California Department of Water Resources.

"Department Costs" shall mean, at any given time, all amounts which the Department is then entitled under Section 80110 of the Act to recover, as a revenue requirement, to enable it to comply with Section 80134 of the Act, (including amounts payable under the Interim Loan), except that Department Costs, unless specifically provided in this Agreement, exclude Bond Related Costs to the extent that such Bond Related Costs have been recovered from Bond Charges.

"Electrical Corporation" shall have the meaning ascribed thereto in Section 218 of the Public Utilities Code, including any successor and assign thereof.

"Electric Service Provider" shall mean an entity that provides electrical service to one or more retail customers located within the Service Areas of Pacific Gas & Electric, Southern California Edison Company, or San Diego Gas & Electric Company or any of their respective successors, except that Electric Service Provider excludes: the Department, any other public agency to the extent that it offers electrical service to customers within its jurisdiction or within the service territory of a local publicly owned electric utility, and Electrical Corporations. Electric Service Provider includes the unregulated affiliates and subsidiaries of an Electrical Corporation.

"Fiduciary" shall mean any Trustee, any bond registrar and any paying agent in connection with Bonds pursuant to the Financing Documents, and their respective successors and assigns.

"Financing Documents" shall mean any resolution, indenture, trust agreement, loan agreement, revolving credit agreement, reimbursement agreement, standby purchase agreement or other agreement or instrument adopted or entered into by the Department authorizing, securing or enhancing the Bonds, including any bond offering documents, as from time to time amended or supplemented in accordance therewith. Copies of all Financing Documents shall be provided to the Commission.

"Fund" shall mean the Department of Water Resources Electric Power Fund established by the Act.

"Interim Loan" shall mean obligations issued under the Credit and Security Agreement, dated as of June 26, 2001, among the Department and various lenders identified therein and Morgan Guaranty Trust Company of New York, in its capacity as agent for the lenders, and other documents and agreements described therein.

"Minimum Operating Reserve Account Requirement" shall have the meaning set forth in the Financing Documents, and shall include an amount solely limited to make payments due under the Priority Long Term Power Contracts if funds are not available in the Operating Account or the Priority Contract Account.

"Operating Account" shall have the meaning set forth in the Financing Documents. The purpose of the Operating Account is to provide for the payment of Department Costs, including by transfer to the Priority Contract Account. Power Charges will generally be deposited into the Operating Account.

"Operating Reserve Account" shall have the meaning set forth in the Financing Documents. The purpose of the Operating Reserve Account is to provide for the payment of Department Costs in the event that amounts in the Operating Account are insufficient, or amounts in the Priority Contract Account are insufficient to make payments due under the Priority Long Term Power Contracts.

"Power" shall have the meaning ascribed thereto in Section 80010 of the Water Code.

"Power Charges" shall mean charges imposed by the Commission upon Retail End Use Customers for electric power deemed sold to Retail End Use Customers by the Department, except that Power Charges exclude Bond Charges.

"Priority Contract Account" shall have the meaning set forth in the Financing Documents. The purpose of the Priority Contract Account is to provide solely for the payment of amounts due under Priority Long Term Power Contracts.

"Priority Long Term Power Contracts" shall mean (i) those long-term electric power contracts identified in Appendix A, and shall not include any electric power contracts entered into after August 14, 2001; provided, however, that such term shall include any priority long term electric power contract entered into after August 14, 2001, as an amendment or novation of any Priority Long Term Power Contract and (ii) any contracts entered into for the purpose of securing fuel for use at generating facilities being operated pursuant to such Priority Long Term Power Contracts, if that fuel supply contract contains a provision to the general effect that payments by the Department under the contract are to be paid or payable prior to bonds, notes, or other indebtedness of the Department secured by a pledge or assignment of the revenues of the Department under the Act and other amounts in the Fund. The Department shall consult with the Commission prior to entering into any additional contract for the purpose of securing fuel

if that contract contains such a provision. Contracts shall cease to be treated as Priority Long Term Power Contracts under the circumstances described in Section 7.8.

"Retail End Use Customer" shall mean each customer within the Service Area of an Electrical Corporation that is deemed to purchase electric power from the Department under the Act.

"Retail Revenue Requirements" shall mean the amounts required to pay Department Costs that are to be generated from Power Charges imposed by the Commission from time to time.

"Service Area" shall mean the geographic area in which an Electrical Corporation distributes electricity.

"State" shall mean the State of California.

"Trustee" shall mean any bank or trust company, or the State Treasurer, appointed as trustee, co-trustee or collateral agent in connection with the Bonds or bond related obligations pursuant to the Financing Documents, and its successors and assigns.

ARTICLE II
REPRESENTATIONS AND WARRANTIES

Section 2.1 Representations and Warranties of Department. The Department makes the following representations and warranties as the basis for the undertakings on its part herein contained:

(a) It is a department within the Resources Agency of the State, validly existing under the Constitution and laws of the State, and has full power and authority to execute, deliver and perform and observe all of the terms and provisions of this Agreement.

(b) The execution, delivery and performance of this Agreement have been duly authorized by all necessary action on the part of the Department.

(c) This Agreement is a legal, valid and binding agreement of the Department and is enforceable against the Department in accordance with its terms.

Section 2.2 Representations and Warranties of Commission. The Commission makes the following representations and warranties as the basis for the undertakings on its part herein contained:

(a) It is a commission of the State, validly existing under the Constitution and laws of the State, and has full power and authority to execute, deliver and perform and observe all of the terms and provisions of this Agreement.

(b) The execution, delivery and performance of this Agreement, have been duly authorized by all necessary action on the part of the Commission.

(c) This Agreement is a legal, valid and binding agreement of the Commission and is enforceable against the Commission in accordance with its terms.

ARTICLE III
AGREEMENTS FOR BOND ISSUANCE

Section 3.1 Agreement for Bond Issuance. The Department and the Commission agree that this Agreement is executed to facilitate the issuance of Bonds and solely for the benefit of the Beneficiaries.

Section 3.2 No Indebtedness. Nothing contained in the Agreement shall be deemed to create or constitute a debt or liability of the State or of any political subdivision thereof, or a pledge of the full faith and credit or taxing power of the State or of any such political subdivision.

Section 3.3 No Pecuniary Liability of Commission. Nothing in this Agreement shall be deemed to create any pecuniary liability of the Commission, its Commissioners, employees or agents to any person, the sole remedy for any default, breach or other nonperformance by the Commission hereunder being the exercise of remedies specifically afforded hereunder and under the Act.

ARTICLE IV
RETAIL REVENUE REQUIREMENTS; JUST AND REASONABLE COSTS

Section 4.1 Retail Revenue Requirements.

(a) Generally. The Commission agrees to cooperate with and assist the Department in its review, determination and revision of its Retail Revenue Requirement at the request of the Department. The Department shall promptly notify the Commission following any determination or revision of the Retail Revenue Requirements. If any such annual or more frequent review indicates that the Power Charges are, or will be, insufficient to meet the requirements of the Act, and the Department so notifies the Commission, the Commission shall take necessary action to cure or avoid any such deficiency, including adjustment of existing, and the calculation and imposition of additional, Power Charges. To the extent that the Department has not provided a revised Retail Revenue Requirement to the Commission within the time periods required by subsection (b) below for any reason and the Commission determines based on the record before it, that Power Charges are not sufficient to pay Department Costs (which for this purpose include replenishment of the Bond Charge Collection Account, Bond Charge Payment Account or Debt Service Reserve Account), the

Commission may modify Power Charges to cover such shortfall on an interim basis pending receipt of a revised Retail Revenue Requirement from the Department.

(b) Communication. The Department shall, at least annually, and more frequently as deemed reasonably necessary or appropriate by the Department or the Commission, review, determine and revise its Retail Revenue Requirements. The Department agrees that it shall revise and communicate to the Commission its Retail Revenue Requirement within 20 days of the occurrence of any of the following circumstances, whether or not the Commission notifies the Department of such events: (i) the Department projects that, within 120 days, there will be insufficient funds in the Priority Contract Account to pay costs incurred by the Department under the Priority Long Term Power Contracts, or (ii) the Department projects that, within 120 days, there will be less than the Minimum Operating Reserve Account Requirement in the Operating Reserve Account, or (iii) the Department projects that, within 120 days, shortfalls in the Priority Contract Account, Operating Account and the Operating Reserve Account will require the usage of moneys in the Bond Charge Collection Account to pay costs incurred by the Department under the Priority Long Term Power Contracts, or (iv) the Department projects that, moneys in the Debt Service Reserve Account will be used within 120 days to pay Bond Related Costs. The Department further agrees that if a revised Retail Revenue Requirement has not previously been submitted pursuant to the preceding sentence of this Section 4.1 the Department shall revise and communicate to the Commission within 3 business days its Retail Revenue Requirement in the event that the Department makes any withdrawal from the Bond Charge Collection Account to pay specified Department Costs, or from the Operating Reserve Account or the Debt Service Reserve Account such that, in either case, the amount in such account is less than that required under the Financing Documents.

(c) Information. In any determination of the Retail Revenue Requirements, the Department shall include the amount required to be recovered in the applicable period and shall set forth amounts projected to be required to be collected during subsequent periods in which either Bonds will remain outstanding or the Department will continue to sell Power, but not exceeding the five years succeeding the applicable revenue requirement period. The Retail Revenue Requirements for any period shall take into account any deficiency or any surplus in amounts recovered in earlier periods, as well as any anticipated surpluses in the Priority Contract Account, Operating Account and the Operating Reserve Account in the period. The Department's notification to the Commission of the Retail Revenue Requirements shall include a statement containing the Department's projections (with reasonable detail) of the following information for each month during the period covered by the Retail Revenue Requirements:

(i) the beginning balance of funds on deposit in the Fund, including the amounts on deposit in each account and subaccount of the Fund;

(ii) the amounts necessary to pay or provide for the principal of, premium, if any, and interest on all Bonds and all other Bond Related Costs under the

Financing Documents as and when the same shall become due and the amount of Bond Charges to be collected for such purpose;

(iii) the amount of its Retail Revenue Requirement for that month;

(iv) any other information requested by the Commission in its proceedings implementing a Retail Revenue Requirement.

(d) Additional Information. The Department shall provide the Commission as soon as practicable, but no later than 30 days after the end of each month, a report of Department receipts and Department Costs for the prior month, based upon the sums of known actual Department receipts and Department Costs and estimated accruals for those receipts and costs which are subject to final invoicing or accounting settlement processes. Such monthly report shall be presented in a form which enables reasonable comparison to the monthly estimates contained in the latest Retail Revenue Requirement for (i) long term Department contract electric power purchases, (ii) short term Department electric power purchases, (iii) other electric power purchases or reimbursement by the Department of purchases of electric power by others for which the Department is responsible for payment, and (iv) Department administrative costs. For items (i), (ii) and (iii) above, the Department shall report information with a level of detail that lists each counterparty, the volumes provided by the counterparty, and the cost of those volumes. In addition, for those items, the costs and volumes will be separated into day ahead, hour ahead, "out of market" purchases, and contract categories, or such comparable categories as shall be in place at the time. The Department shall also report to the Commission on a monthly basis the balance in each of the accounts or subaccounts the Department is required to keep pursuant to the Financing Documents. When actual or additional information becomes available for any of the reports identified in this Section 4.1(d), the Department will communicate such information to the Commission. In addition, the Department's monthly reports shall contain the information required by Section 4.1(c)(ii).

(e) The Commission shall receive any financial reports prepared by the Department as required by the Financing Documents at the same time as the recipients under the Financing Documents.

Section 4.2 Just and Reasonable Costs. The Department agrees that prior to including any cost in the Retail Revenue Requirements communicated to the Commission in accordance with Section 4.1(a), the Department will conduct whatever procedures are required by law to determine that such cost is just and reasonable within the meaning of Section 451 of the California Public Utilities Code.

Section 4.3 ESP Power. Bond Charges may be based on electric power provided to customers by Electric Service Providers only after an order of the Commission providing for such charges becomes final and unappealable.

ARTICLE V
RATE COVENANT

Section 5.1 Rate Covenant.

(a) The Commission hereby covenants and agrees to calculate, revise and impose from time to time, Bond Charges sufficient to provide moneys so that the amounts available for deposit in the Bond Charge Payment Account from time to time, together with amounts on deposit in the Bond Charge Payment Account, are at all times sufficient to pay or provide for the payment of all Bond Related Costs when due in accordance with the Financing Documents.

(b) As provided by Section 80112 of the Act and as authorized by Section 80110 of the Act, including by reference to Article 5.5 (commencing with Section 840) of Chapter 4 of Part 1 of Division 1 of the California Public Utilities Code, the Bond Charges authorized by Commission Order and the right of the Department to receive Bond Charges as provided in this Agreement shall be property of the Department for all purposes under California law.

(c) As authorized by Section 80110 of the Act by reference to Article 5.5 (commencing with Section 840) of Chapter 4 of Part 1 of Division 1 of the California Public Utilities Code, Sections 5.1(a) and 5.1(b) of this Agreement shall have the force and effect of a "financing order" adopted thereunder and shall be irrevocable and enforceable in accordance with the terms hereof, including, without limitation, in circumstances in which the Department has breached its obligations under this Agreement or in respect of the Financing Documents.

(d) If the Department has complied with Article IV hereof to the extent applicable, but nevertheless projects that there will be insufficient monies on deposit in the Bond Charge Payment Account to make timely payment of Bond Related Costs, the Department shall submit to the Commission a request that the Commission increase Bond Charges to make timely payment of Bond Related Costs and the Commission agrees that it shall calculate and impose revised Bond Charges to pay such Bond Related Costs no later than 120 days from the date following the delivery to the Commission by the Department of its request for revised Bond Charges, provided, to the extent the insufficiency in the Bond Charge Payment Account relates to an insufficiency of Power Charges to provide for certain specified Department Costs, the Commission agrees that, no later than 120 days from the date on which the Department submits a revised Retail Revenue Requirement pursuant to Article IV covering the same projected insufficiency in the Bond Charge Payment Account, it shall respond to the revised Retail Revenue Requirement or the Bond Charge request. Whether or not the Department makes the foregoing requests, the Commission shall, in all instances, be bound by its covenants in this Article V.

ARTICLE VI
COVENANTS OF THE COMMISSION

Section 6.1 Power Charges.

(a) The Commission hereby covenants and agrees to calculate, revise and impose, from time to time, Power Charges sufficient to provide moneys in the amounts and at the times necessary to satisfy the Retail Revenue Requirements as specified by the Department.

(b) Power Charges and Bond Charges shall be established by the Commission without regard to the levels or amounts of any particular rates or charges authorized by the Commission to be charged by any Electrical Corporation for electrical power sold by such Electrical Corporation.

(c) The Commission acknowledges that, as provided by Section 80112 of the Act, Power Charges shall be property of the Department for all purposes under California law.

(d) The Commission agrees that it shall calculate and impose Power Charges no later than 120 days following the delivery to the Commission by the Department of a statement of new or revised Retail Revenue Requirements that complies with Article IV hereof.

Section 6.2 Compliance with Agreement.

(a) The Commission hereby covenants with the Department that the Commission shall take all such actions or refrain from taking all such actions, as the case may be, so as to comply with the terms and provisions of the Act and this Agreement.

(b) The Commission hereby covenants that, so long as any Bonds shall be outstanding, it will not take any action, or fail to take any action, which, if taken or not taken, as the case may be, would adversely affect the tax-exempt status of the interest payable on Bonds or Interim Loan obligations then outstanding, the interest on which, at the time of issuance thereof, was exempt from Federal income taxation or not includable in gross income for purposes of Federal income taxation. In furtherance of the foregoing, the Commission agrees to act with respect to those matters within its control that could adversely affect the exclusion of interest on Bonds or Interim Loan obligations from gross income for purposes of federal income taxation.

Section 6.3 Liens. Until the Bonds have been paid in full or provision has been made therefor in accordance with the Financing Documents, the Commission, to the extent it has the power to do so, shall not permit to be created any purported lien upon or pledge of the Power Charges or the Bond Charges except any lien and pledge thereon created by or pursuant to the Act as security for the enforcement of the Department's obligations (including the Interim Loan) entered into pursuant thereto.

Section 6.4 Commission Acknowledgment. The Commission acknowledges that the Department intends to enter into Financing Documents that permit certain specified Department Costs to be funded out of amounts available in the Bond Charge Collection Account if insufficient moneys are available in the Priority Contract Account, Operating Account and the Operating Reserve Account to pay such specified Department Costs. In the event that such Department Costs are funded out of the Bond Charge Collection Account, the Department shall take such actions as are required under this Agreement so that the amounts applied from the Bond Charge Collection Account for such purpose shall be replenished from Power Charges, provided that any failure to do so by the Department shall not mitigate or alter the Commission's obligations under Article V.

ARTICLE VII
COVENANTS OF THE DEPARTMENT

Section 7.1 Retail Revenue Requirement. The Department hereby covenants and agrees to calculate and revise its Retail Revenue Requirement only for the purpose of recovering costs which it is permitted to collect under the Act, (including amounts payable under the Interim Loan), and not to cover any costs in connection with its responsibilities under the Act which it cannot include in such a Retail Revenue Requirement.

Section 7.2 Department Participation. Consistent with the limitations set forth in Water Code Section 80110, upon the request of the Commission, the Department will participate in any Commission proceedings, including providing witnesses, attending public hearings and providing any other materials necessary to facilitate the Commission's completion of its proceedings, taken in connection with the establishment of Power Charges or Bond Charges by the Commission.

Section 7.3 Compliance with Agreement.

(a) The Department hereby covenants with the Commission that the Department shall take all such actions or refrain from taking all such actions, as the case may be, so as to comply with the terms and provisions of the Act and this Agreement, including but not limited to, complying with the legal requirements referenced in Article IV and the requirement to review its Retail Revenue Requirement at least annually.

(b) The Department hereby covenants that, so long as any Bonds shall be outstanding, it will not take any action, or fail to take any action, which, if taken or not taken, as the case may be, would adversely affect the tax-exempt status of the interest payable on Bonds or Interim Loan obligations then outstanding, the interest on which, at the time of issuance thereof, was exempt from Federal income taxation or not includable in gross income for purposes of Federal income taxation. In furtherance of the foregoing, the Department agrees to act with respect to those matters within its control

that could adversely affect the exclusion of interest on Bonds or Interim Loan obligations from gross income for purposes of federal income taxation.

Section 7.4 Charges. The Department acknowledges the Commission's exclusive authority to spread the Department's revenue requirement among customer classes and service territories and to determine the extent or timing of rate changes that may be required in the future, consistent with the Commission's obligations in this Rate Agreement. As long as this Agreement is in effect the Department agrees that it will not attempt to fix or establish charges on retail end use customers for the purpose of paying Department Costs or Bond Related Costs. Nothing in this Agreement shall be read to establish that the Department does or does not have the authority to fix or establish such charges.

Section 7.5 Department Audits. The Department shall provide to the Commission when available a copy of any audit conducted pursuant to Section 80270 of the Act and a copy of each of the Department's audited annual financial statements for the Fund.

Section 7.6 Proceeds. The Department shall sell Bonds, as soon as practicable, in amounts sufficient to provide for the repayment to the General Fund of the State of the advances made under the Act to the Fund, together with interest on such advances as provided by the Act. The Department shall apply the proceeds of the Bonds to repayment of the General Fund with the understanding that repayment of the Interim Loan in full has priority and that the following costs may have priority: creation of adequate reserves for the payment of Bond Related Costs and payment of costs of issuance.

Section 7.7 Renegotiation of Power Contracts. The Department shall use its best efforts to renegotiate or modify its long term Power contracts.

Section 7.8 Priority Long Term Power Contracts. Any Priority Long Term Power Contract that is amended, replaced or terminated so that any resulting contract no longer contains a provision to the general effect that payments by the Department under the contract are to be paid or payable prior to bonds, notes, or other indebtedness of the Department secured by a pledge or assignment of the revenues of the Department under the Act and other amounts in the Fund shall no longer be treated as a Priority Long Term Power Contract. The Department shall immediately notify the Commission of any such amendment, replacement or termination.

Section 7.9 Appointment of Trustee. To the extent practicable, the Department shall appoint as Trustee a bank, trust company or other qualified entity or person that does not itself, or by or through any of its corporate affiliates, trade in electricity or natural gas commodity markets, and does not itself, or any of its affiliates, appear on the list of top twenty creditors for any Electrical Corporation or any entity providing electric power to the Department that has petitioned for bankruptcy.

Section 7.10 Financing Documents. The Department shall involve, to the fullest extent possible, the Commission in the development and completion of all Financing Documents and shall consult with the Commission on the sizing of operating and debt service reserves, debt service coverage, the maturity and maximum amount of Bonds to be issued and any other matters in the Financing Documents which the Commission deems material. The Department has submitted to the Commission a summary (the "Summary") of the material terms of the Financing Documents securing its Bonds. ("Material terms" means the maximum amount of the Bonds authorized, their maturity, a description of the flow of funds and a description of the sizing or methodology of sizing of reserves held or created pursuant to the Financing Documents or debt service coverage required thereby.) If the Department makes any material change to any such terms it must obtain the approval of the Commission's designee. For purposes of the last sentence, "material change" means (i) a change in the sizing or methodology of sizing of debt service reserves that would increase the projected net debt service on the Bonds by more than an amount specified in the Summary; (ii) an increase in debt service coverage required by the Financing Documents by more than an amount specified in the Summary; (iii) a change in the sizing or method of sizing of operating reserves by more than an amount specified in the Summary; (iv) any increase in the maximum amount of the Bonds authorized; (v) a change in the maturity of the Bonds beyond those changes permitted in the Summary; or (vi) a change in the flow of funds beyond those changes permitted in the Summary. At the time the Commission adopts the Rate Agreement, it will appoint a designee for purposes of this Section 7.10. Nothing in this Section 7.10 shall imply that the Commission or its designee shall have the right to approve (i) the final amortization, interest rates, or methods of determination, denominations, redemption provisions or pricing of the Bonds or (ii) final sizing of reserves and debt service coverage based on pricing considerations, or (iii) except to the extent set forth above in this Section 7.10, the terms of any revolving credit agreement, reimbursement agreement, standby purchase agreement, liquidity or credit enhancement facility, or swap agreement or other hedging agreement entered into in connection with the Bonds, or (iv) any agreements or arrangements with any Fiduciary incident to the issuance of the Bonds or (v) any offering document used in connection with the offering of the Bonds (except with respect to sections of the offering document relating to the Commission.)

ARTICLE VIII
EVENTS OF DEFAULT AND REMEDIES

Section 8.1 Events of Default. An "event of default" or a "default" shall mean, whenever they are used in this Agreement, a failure of the Commission to calculate and impose Bond Charges in accordance with Article V.

Section 8.2 Remedies.

(a) Whenever any event of default shall have occurred and be continuing, and written notice of the default shall have been given to the Commission by the Department and the default shall not have been cured within 30 days, the Department

may take whatever action at law or in equity may appear necessary or desirable to enforce performance and observance of any obligation, agreement or covenant of the Commission under Article V.

(b) Whenever any event shall have occurred and be continuing, such that either the Commission or the Department is not in compliance with any covenant or obligation of this Agreement, and written notice of the breach of such covenant or obligation shall have been given to either the Commission or the Department and the breach shall not have been cured within 30 days, both the Commission or the Department may take whatever action at law or in equity that may appear necessary or desirable to enforce performance and observance of any obligation, agreement or covenant under this Agreement.

Section 8.3 Consent to Assignment.

(a) The Commission consents to the collateral assignment by the Department to the Trustee for the benefit of the Beneficiaries, as such, of the covenants of the Commission contained in Article V; provided, however, that any rights so granted to the Trustee shall not be greater than the rights of the Department under such Sections of this Agreement, and such right on the part of the Trustee to enforce such covenants shall only commence after the Department has both defaulted under its obligations contained in the Financing Documents and has failed to enforce such covenants in accordance with the terms of this Agreement. Prior to exercising any rights granted to the Trustee in accordance with this Section 8.3, the Trustee shall be required to (i) give prior written notice within the time period required in Section 8.3(b) below, (ii) certify to the Commission that an event of default, other than an event of default predicated solely on the Commission's failure to act hereunder, has occurred under the Financing Documents and (iii) comply or cause the Department to comply with the provisions of this Agreement relating to the Department's rights, duties and obligations hereunder.

(b) In addition to the requirements of Section 8.3(a) for exercising its rights hereunder, unless a default has resulted in the amount in the Debt Service Reserve Account being insufficient to pay or provide for the timely payment of all Bond Related Costs in accordance with the Financing Documents, the Trustee shall give the Commission 30 days prior written notice of the exercise by the Trustee of any of the Department's rights under Section 5.1 hereof.

ARTICLE IX
TERMINATION

Section 9.1 Termination. The Agreement shall terminate, and the covenants and other obligations contained in the Agreement shall be discharged and satisfied, when payment of the Bonds and all other Bond Related Costs required to be paid by the Department under the Financing Documents have been made or provided for in accordance with the Financing Documents.

ARTICLE X
AMENDMENTS

Section 10.1 Amendments to Agreement. No amendment to the Agreement shall be effective unless it is in writing and signed by each of the parties hereto, provided, however, on or after the issuance of the Bonds, Sections 5.1(a) and (b) may not be amended.

ARTICLE XI
MISCELLANEOUS

Section 11.1 No Waiver. No failure to exercise, and no delay in exercising by the parties hereto, any right, power or privilege hereunder shall operate as a waiver thereof; nor shall any single or partial exercise of any right, power or privilege hereunder preclude any other or further exercise thereof, or the exercise of any right, power or privilege. The rights and remedies herein provided are cumulative and not exclusive of any rights or remedies provided by law, including the Act.

Section 11.2 Notices. All notices, requests and other communications under this Agreement shall be deemed to have been duly given if in writing and delivered personally or by certified mail (a) to the Department at 1416 9th Street, 11th Floor, Sacramento, California 95814, attention: Director; (b) to the Commission at 505 Van Ness Avenue, San Francisco, California 94102, attention: Executive Director and General Counsel; or such other address as the Department, or the Commission, as the case may be, shall hereafter designate by notice in writing to the other party.

Section 11.3 Severability. In the event that any one or more of the provisions contained in the Agreement is or are invalid, irregular or unenforceable in any respect, the validity, regularity and enforceability of the remaining provisions contained in this Agreement shall be in no way affected, prejudiced or disturbed thereby.

Section 11.4 Headings. The descriptive headings of the several articles of the Agreement are inserted in the Agreement for convenience only and shall not be deemed to affect the meaning or construction of any of the provisions of the Agreement.

Section 11.5 Governing Law. The Agreement shall be governed by, and construed in accordance with, the Constitution and laws of the State of California, without regard to the provisions thereof regarding conflicts of law.

Section 11.6 Counterparts. This Agreement may be executed in several counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument.

Section 11.7 Date of Agreement. The date of this Agreement shall be for identification purposes only. This Agreement shall become effective immediately upon execution and delivery by the parties hereto.

Section 11.8 Third Party Beneficiaries. Nothing in this agreement express or implied shall be construed to give any person or entity, other than the parties hereto and the Beneficiaries, any legal or equitable right, remedy, or claim under or in respect of the agreement or any covenants, agreements, representations, or provisions contained herein.

Section 11.9 Applicability. This Agreement does not apply to any Retail Revenue Requirement under consideration by the Commission as of the date of this Agreement, but does apply to any Retail Revenue Requirement submitted thereafter. Prior to the issuance of any Bonds, any provision of this Agreement referring to an account or subaccount under the Financing Documents shall be interpreted to achieve the intent of such provision as nearly as practicable.

Section 11.10 No Implied Waivers. Nothing in this Agreement shall be construed to limit the rights of the Commission or the Department to assert any rights it may have with respect to any contract entered into by the Department with respect to its obligations under the Act, or to contest in any proceeding the legality or effect of any contract entered into by the Department with respect to its obligations under the Act.

Section 11.11 No Assignment. Except as set forth in Section 8.3, neither the Department nor the Commission shall assign any of its rights or delegate any of its duties under this Agreement without the express written consent of the other party hereto, provided, however, if, with respect to either party, another governmental entity is created or designated by law to carry out the rights, powers, duties and obligations of such party, then such party may, if required by such law, transfer and assign its right, title and interest in this Agreement to such successor, provided, that such successor entity is permitted by law to assume such party's obligations under this Agreement and agrees in writing to be bound by the terms of this Agreement.

IN WITNESS WHEREOF, the Department has caused this Agreement to be executed in its name by the Director of Water Resources and the Commission by the affirmative vote of the Commission (Decision No. 02-02-051) has caused this Agreement to be executed in its name by those Commissioners who constituted a majority of the Commission when it approved this agreement, all as of the date first above written.

STATE OF CALIFORNIA
DEPARTMENT OF
WATER RESOURCES

By: _____
Director of Water Resources

STATE OF CALIFORNIA PUBLIC
UTILITIES COMMISSION

By: _____
Commissioner

By: _____
Commissioner

By: _____
Commissioner

By: _____
Commissioner

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APPENDIX E

PROPOSED FORM OF OPINION OF ATTORNEY GENERAL

Upon delivery of the Series 2008K Bonds, the Honorable Edmund G. Brown Jr., Attorney General of the State of California, proposes to deliver an opinion in substantially the following form:

California Department of Water Resources
Sacramento, California

Department of Water Resources
Power Supply Revenue Bonds
$_____Series 2008K

Ladies and Gentlemen:

We have acted as Attorney General of the State of California in connection with the issuance by the State of California Department of Water Resources (the "Department") of $_____ aggregate principal amount of its Power Supply Revenue Bonds, Series 2008K (the "Series 2008K Bonds"). The Series 2008K Bonds are issued under and pursuant to the Constitution and laws of the State, including, but not limited to, Division 27 (commencing with Section 80000) of the California Water Code, as amended (the "Act"), and a Trust Indenture dated as of October 1, 2002 (the "Trust Indenture"), among the Department, the Treasurer of the State of California, as Trustee (the "Trustee") and U.S. Bank National Association, as Co-Trustee (the "Co-Trustee"), as supplemented by an Eighth Supplemental Trust Indenture dated as of May 1, 2008, among the Department, the Trustee and the Co-Trustee (collectively with the Trust Indenture, the "Indenture").

In such connection, we have examined the Indenture, the Rate Agreement dated as of March 8, 2002 (the "Rate Agreement"), by and between the Department and the California Public Utilities Commission (the "CPUC"), certifications of the Department, the Trustee, the Co-Trustee, and others, opinions of special counsel to the Department and the CPUC, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein. We have assumed, without undertaking to verify, the genuineness of all documents, certifications and opinions and signatures thereon presented to us (whether as originals or as copies); the accuracy of the factual matters represented, warranted or certified in such documents, certificates and opinions; the correctness of the legal conclusions contained in such opinions; the due and legal execution of such documents and certificates by, and validity thereof against, any parties other than the Department; and compliance with all covenants and agreements contained in the Indenture and the Rate Agreement.

This opinion is issued as of the date hereof. The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. We assume no obligation to update, revise or supplement this opinion to reflect any action hereafter taken or not taken, or any facts or circumstances, or any changes in law or in interpretations thereof, that may hereafter arise or occur, or for any other reason.

In addition, we call attention to the fact that the rights and obligations under the Bonds (as defined in the Trust Indenture), the Indenture and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against the State of California. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum, waiver or severability provisions contained in the documents described herein.

Finally, we express no opinion as to the accuracy, adequacy or sufficiency of any financial or other information which has been or will be supplied to purchasers of the Series 2008K Bonds and undertake no responsibility for the accuracy, completeness or fairness of the Official Statement dated _____, 2008, pertaining to the Series 2008K Bonds or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Department is a department of the State of California, duly established and validly existing under the laws of the State of California.

2. The Indenture has been duly authorized, executed and delivered by the Department, and constitutes the valid and binding agreement of the Department, enforceable against the Department in accordance with its terms.

3. The Series 2008K Bonds constitute valid and binding limited special obligations of the Department payable solely from the Trust Estate (as defined in the Trust Indenture), including the Revenues (as defined in the Trust Indenture), as and to the extent provided in the Indenture. The Series 2008K Bonds do not constitute a debt or liability of the State or of any political subdivision thereof, and do not constitute a general obligation of the Department. Neither the faith and credit nor the taxing power of the State or of any political subdivision thereof is pledged to the payment of the principal of, premium, if any, or interest on the Series 2008K Bonds. The Department has no taxing power.

4. The Trust Indenture permits the Department to issue additional Bonds (as defined in the Trust Indenture), and incur Parity Obligations (as defined in the Trust Indenture) and other obligations thereunder from time to time on the terms and conditions and for the purposes stated therein.

5. The Indenture creates a valid pledge of the Trust Estate, including the Revenues, as set forth in the Indenture, subject only to the provisions of the Indenture permitting the payment or use of the Trust Estate for the purposes, in the manner and upon the terms and conditions set forth in the Indenture. Pursuant to the Act, the pledge of the Trust Estate, including the Revenues, made by the Department in the Indenture is valid, binding and perfected without any physical delivery, recordation, filing or further act, and the lien thereof is valid, binding and perfected against all parties having claims of any kind in tort, contract or otherwise against the Department irrespective of whether such parties have notice thereof.

6. The Rate Agreement has been duly authorized, executed and delivered by the Department and constitutes a valid and binding agreement of the Department, enforceable against the Department in accordance with its terms.

Sincerely,

Deputy Attorney General

For EDMUND G. BROWN, JR.
Attorney General

APPENDIX F

PROPOSED FORM OF OPINION OF BOND COUNSEL

[Closing Date]

California Department of Water Resources
Sacramento, California

Ladies and Gentlemen:

We have acted as bond counsel to the State of California (the "State") Department of Water Resources (the "Department") in connection with the issuance by the Department of $_____ aggregate principal amount of its Power Supply Revenue Bonds, Series 2008K (the "Offered Bonds"). The Offered Bonds are issued under and pursuant to the Constitution and laws of the State, including, but not limited to, Division 27 (commencing with Section 80000) of the California Water Code, as amended (the "Act"), and a Trust Indenture dated as of October 1, 2002 (the "Trust Indenture"), among the Department, the Treasurer of the State, as Trustee (the "Trustee"), and U.S. Bank National Association, as Co-Trustee (the "Co-Trustee"), as supplemented by an Eighth Supplemental Indenture dated as of May 1, 2008, among the Department, the Trustee and the Co-Trustee (collectively, with the Trust Indenture, the "Indenture"). Capitalized terms used but not defined herein shall have the respective meanings given to them in the Indenture.

We have examined a record of proceedings relating to the issuance of the Offered Bonds, and based thereon and on our examination of existing law, such legal proceedings and such other documents as we deem necessary to render this opinion, we are of the opinion that:

1. The Department is duly existing under the laws of the State. Under the laws of the State, including the Constitution of the State, and under the Constitution of the United States, the Act is valid with respect to all provisions thereof material to the subject matters of this opinion letter.

2. The Department is validly authorized under the laws of the State, particularly the Act, to execute and deliver the Indenture and to perform its obligations thereunder. The Indenture has been duly authorized, executed and delivered by the Department and constitutes a valid and binding agreement of the Department, enforceable against the Department in accordance with its terms. You have received an opinion from _____, counsel to the Co-Trustee, to the effect that, among other things, the Indenture has been duly authorized, executed and delivered by the Co-Trustee and constitutes a valid and binding agreement of the Co-Trustee, and with your permission we have assumed such matters for purposes of the opinions in this paragraph 2.

3. The Offered Bonds have been duly and validly authorized and issued in accordance with the laws of the State, including the Constitution of the State, the Act and the Indenture, and constitute valid and binding limited special obligations of the Department payable solely from the Trust Estate, including the Revenues, as provided in the Indenture. The Offered Bonds do not constitute a debt or liability of the State or of any political subdivision thereof, and do not constitute a general obligation of the Department. Neither the faith and credit nor the taxing power of the State or of any political subdivision thereof is pledged to the payment of the principal of, premium, if any, or interest on the Bonds. The Department has no taxing power.

The Trust Indenture permits the Department to issue additional Bonds, and incur Parity Obligations and other obligations, thereunder from time to time on the terms and conditions and for the purposes stated therein. The Offered Bonds, all outstanding Bonds, such additional Bonds, if issued, and such Parity Obligations, if incurred, will be equally and ratably secured under the Trust Indenture except as otherwise provided therein.

4. The Indenture creates the valid pledge which it purports to create of the Trust Estate, including the Revenues, subject only to the provisions of the Indenture permitting the payment or use of the Trust Estate for the purposes, in the manner and upon the terms and conditions set forth in the Indenture. Pursuant to the Act, the pledge of the Trust Estate, including the Revenues, made by the Department in the Indenture is valid, binding and perfected without any physical delivery, recordation, filing or further act, and the lien thereof is valid, binding and perfected against all parties having claims of any kind in tort, contract or otherwise against the Department irrespective of whether such parties have notice thereof.

5. The Department has duly and validly covenanted in the Indenture to cause to be established, fixed and revised from time to time charges with respect to Department Power sufficient, together with any other available moneys and securities on deposit in the Electric Power Fund, to satisfy all the Department's Revenue Requirements at the times and in the amounts needed. In furtherance of such covenant, the Department has entered into a Rate Agreement dated as of March 8, 2002 (the "Rate Agreement") with the California Public Utilities Commission (the "Commission") pursuant to the Act providing for the imposition by the Commission of rates and charges to satisfy the Department's Revenue Requirements. The Rate Agreement has been duly authorized, executed and delivered by the Department.

6. The Rate Agreement is valid and binding on the parties thereto and is enforceable against the parties thereto in accordance with its terms. The Commission has full power and authority to impose Bond Charges as provided in the Rate Agreement. Under the Rate Agreement, the Department has covenanted, among other things, that prior to including any cost in the Retail Revenue Requirements communicated to the Commission in accordance with the Rate Agreement, the Department will conduct whatever procedures are required by law to determine that such cost is just and reasonable within the meaning of Section 451 of the California Public Utilities Code. However, under the rate covenant in the Rate Agreement, the Commission has the obligation to impose Bond Charges to provide moneys sufficient to pay all Bond Related Costs when due, including debt service on the Bonds (including the Offered Bonds), and this obligation as set forth in the rate covenant is not conditioned upon any determination that the Department's costs are just and reasonable under Section 451 of the California Public Utilities Code.

7. No registration with, consent of, or approval by any governmental officer, agency or commission is necessary for the execution and delivery by the Department of the Indenture, the Offered Bonds or the Rate Agreement, other than those that have been obtained.

8. The Department has validly included in the Indenture and the Offered Bonds the pledge and undertaking of the State that so long as any obligations of the Department incurred under the Act, including without limitation the Indenture, the Bonds and Parity Obligations, remain outstanding and not fully performed or discharged, the rights, powers, duties and existence of the Department and the Commission shall not be diminished or impaired in any manner that will adversely affect the interests and rights of the holders of or parties to such obligations.

9. Under existing statutes, interest on the Offered Bonds is exempt from State of California personal income taxes.

10. Under existing statutes and court decisions, interest on the Offered Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Tax Code of 1986, as amended (the "Tax Code"). Under the Tax Code, interest on the Offered Bonds is not treated as a preference item in calculating alternative minimum taxable income for purposes of the alternative minimum tax applicable to individuals and corporations; such interest, however, is includable in the adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations by the Tax Code. In rendering the opinions in this paragraph 10, we have relied upon and assumed (i) the material accuracy of the representations, statements of intention and reasonable expectations, and certifications of fact, contained in the Tax Certificate delivered on the date hereof by the Department with respect to the use of proceeds of the Offered Bonds and the investment of certain funds, and other matters affecting the exclusion of interest on the Offered Bonds from gross income for Federal income tax purposes under Section 103 of the Tax Code, and (ii) compliance by the Department with procedures and covenants set forth in the Tax Certificate and with the tax covenants set forth in the Indenture as to such matters. Under the Tax Code, failure to comply with such procedures and covenants may cause the interest on the Offered Bonds to be included in gross income for Federal income tax purposes, retroactive to the date of issuance of the Offered Bonds, irrespective of the date on which such noncompliance occurs or is ascertained.

Except as stated in paragraphs 9 and 10 above, we express no opinion as to any Federal, State or local tax consequences arising with respect to the Offered Bonds or the ownership or disposition thereof. Furthermore, we express no opinion as to the effect of any action hereafter taken or not taken in reliance upon an opinion of counsel other than ourselves on the exclusion from gross income for Federal income tax purposes of interest on the Offered Bonds, or under State and local tax law.

You have received an opinion of Lionel B. Wilson, Interim General Counsel to the Commission, to the effect that, among other things, (i) the Commission's Decision No. 02-02-051 dated February 21, 2002, approving the Rate Agreement is final and unappealable under the laws of the State, (ii) the Rate Agreement has been duly executed and delivered by the

Commission, and (iii) the Commission has lawfully consented to, in accordance with the Rate Agreement and such Decision, the issuance by the Department of the outstanding principal amount of the Bonds, and with your permission we have assumed such matters for purposes of the opinions expressed in this letter.

We call attention to the fact that the enforceability of rights and remedies with respect to the Offered Bonds, the Indenture and the Rate Agreement may be limited by, and may be subject to: bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights; the application of equitable principles; the exercise of judicial discretion in appropriate cases; and generally applicable limitations on legal remedies against the State. We express no opinion with respect to any indemnification, contribution, choice of law, choice of forum or waiver provisions contained in the foregoing documents.

We express no opinion as to the accuracy, adequacy or sufficiency of any financial or other information which has been or will be supplied to purchasers of the Offered Bonds.

This letter is issued as of the date hereof, and we assume no obligation to update, revise or supplement this opinion to reflect any action hereafter taken or not taken, or any facts or circumstances, or any changes in law or in interpretations thereof, that may hereafter arise or occur, or for any other reason.

Very truly yours,

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APPENDIX G

INDEX OF PRINCIPAL DEFINITIONS

The following is an index of certain terms used in the forepart of this Official Statement, with references to the pages on which the definitions or descriptions of such terms may be found. Other terms used but not defined or described in the forepart of this Official Statement have the meanings given in APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE – Definitions."

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APPENDIX H

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (the "Disclosure Certificate") is executed and delivered by the State of California Department of Water Resources (the "Department") in connection with the issuance of its Power Supply Revenue Bonds, Series 2008K (the "Bonds"). The Bonds are being issued pursuant to the Trust Indenture among the Department, the Treasurer of the State of California, as Trustee, and U.S. Bank National Association, as Co-Trustee, dated as of October 1, 2002, as amended and supplemented (the "Indenture"). The Department covenants and agrees as follows:

SECTION 1. *Purpose of the Disclosure Certificate*. This Disclosure Certificate is being executed and delivered by the Department for the benefit of the Owners and Beneficial Owners of the Bonds and in order to assist the Participating Underwriters in complying with the Rule.

SECTION 2. *Definitions*. In addition to the definitions set forth in the Indenture, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

"Annual Report" shall mean any Annual Report provided by the Department pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

"Beneficial Owner" shall mean any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds (including persons holding Bonds through nominees, depositories and other intermediaries).

"Central Post Office" means the DisclosureUSA website maintained by the Municipal Advisory Council of Texas or any successor thereto, or any other organization or method approved by the staff or members of the Securities and Exchange Commission (the "SEC") as an intermediary through which issuers may, in compliance with the Rule, make filings required by this Disclosure Certificate.

"Consultant's Report" shall mean the report of Navigant Consulting, Inc., appended as Appendix A to the Official Statements for the Power Supply Revenue Bonds, Series 2002.

"Dissemination Agent," if any, shall mean the person or firm, or any successor Dissemination Agent, designated in writing by the Department pursuant to Section 7 of this Disclosure Certificate and which has filed with the Department and the Trustee a written acceptance of such designation.

"Listed Event" shall mean any of the events listed in Section 5(a) of this Disclosure Certificate.

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. The National Repositories currently approved by the Securities and Exchange Commission can be obtained at http://www.sec.gov/info/municipal/nrmsir.htm.

"Official Statement" shall mean the Department's final Official Statement relating to the Bonds.

"Participating Underwriter" shall mean any of the original underwriters of the Bonds.

"Repository" shall mean each National Repository and the State Repository.

"Rule" shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"State" shall mean the State of California.

"State Repository," if any, shall mean any public or private repository or entity designated by the State as the state repository for the purpose of the Rule and recognized as such by the Securities and Exchange Commission. As of the date of this Certificate, there is no State Repository.

SECTION 3. *Provision of Annual Reports*. For so long as any Bonds are Outstanding:

(a) The Department shall, or shall cause the Dissemination Agent to, not later than nine (9) months after the end of the Department's Fiscal Year (presently June 30), commencing with the report due on or before March 31, 2009, provide to each Repository an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Certificate, with a copy to the Trustee. The Annual Report may be submitted as a single document or as separate documents comprising a package, and may cross-reference other information as provided in Section 4 of this Disclosure Certificate; provided that the audited financial statements of the Department may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. If the Department's Fiscal Year changes, it shall give notice of such change in the same manner as for a Listed Event under Section 5(b).

(b) Not later than fifteen (15) Business Days prior to the due date of each Annual Report as specified in subsection (a), the Department shall provide the Annual Report to the Dissemination Agent, if any. If the Department is unable to provide the Repositories an Annual Report by its due date, the Department shall send a notice to each Repository or the Municipal Securities Rulemaking Board and the State Repository, if any, in substantially the form attached as Exhibit A. The Department reserves the right to make this filing, or cause this filing to be made, through the Central Post Office.

(c) If a Dissemination Agent is appointed by the Department, the Dissemination Agent shall:

(i) determine, prior to the due date of each Annual Report, the name and address of each National Repository and the State Repository, if any or the Central Post Office, as applicable; and

(ii) file a report with the Department certifying that the Annual Report has been provided pursuant to this Disclosure Certificate, stating the date it was provided and listing all the Repositories to which it was provided or that it was provided to the Central Post Office, as applicable.

SECTION 4. *Content of Annual Reports*. The Department's Annual Report shall contain or include by reference the following:

(a) The audited financial statements of the Department relating to its Electric Power Fund for the prior Fiscal Year, prepared in accordance with generally accepted accounting principles applicable to governmental entities, as specified from time to time by the Government Accounting Standards Board. If such audited financial statements are not available by the time the Annual Report is required to be filed pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements and such audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(b) Operating results and other financial data for the prior calendar year (to the extent not otherwise included in the Annual Report pursuant to this Section 4), in the categories set forth in the table under the caption "Summary of Operating Results" in the Official Statement, but only to the extent such information is or becomes historical and does not constitute projections.

(c) Financial and operating data for the prior calendar year (to the extent not otherwise included in the Annual Report pursuant to this Section 4), in the categories set forth in the table entitled "Estimated Average Power Charges and Bond Charges to the Customers" in the Consultant's Report, but only to the extent such information is or becomes historical information and does not constitute projections.

(d) The Department's residual net short costs and direct access surcharge revenues, if any, for the prior calendar year (to the extent not otherwise included in the Annual Report pursuant to this Section 4).

(e) The Department's staffing of its power supply program, specifying the number of permanent staff, number of contract employees and consulting advisors and number of employees on loan from other departments within State government, as of December 31 of the prior calendar year.

Any or all of the items listed above may be included by specific reference to other documents, including official statements relating to debt issues of the Department, which have been submitted to each of the Repositories or the Securities

and Exchange Commission. If the document included by reference is a final official statement, it must be available from the Municipal Securities Rulemaking Board. The Department shall clearly identify each document so included by reference.

SECTION 5. *Reporting of Material Events*. For so long as any Bonds are Outstanding:

(a) Pursuant to the provisions of this Section 5, the Department shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material:

1. principal and interest payment delinquencies;

2. non-payment related defaults;

3. modifications to rights of Bondholders;

4. optional, contingent, or unscheduled bond calls;

5. defeasances;

6. rating changes;

7. adverse tax opinions or events affecting the tax-exempt status of the Bonds;

8. unscheduled draws on the debt service reserves reflecting financial difficulties;

9. unscheduled draws on the credit enhancements reflecting financial difficulties.;

10. substitution of the credit or liquidity providers or their failure to perform; and

11. release, substitution or sale of property securing repayment of the Bonds.

(b) The Department shall promptly file or caused to be filed a notice of each occurrence of a Listed Event, if material, with the Repositories or the Municipal Securities Rulemaking Board and the State Repository, with a copy to the Trustee.

(c) Notwithstanding the immediately preceding subsection (b), the Department reserves the right to file the notice required by such subsection through the Central Post Office.

SECTION 6. *Termination of Reporting Obligation*. The Department's obligations under this Disclosure Certificate shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Bonds. If such termination occurs prior to the final maturity of the Bonds, the Department shall give notice of such termination in the same manner as for a Listed Event under Section 5(b).

SECTION 7. *Dissemination Agent*. The Department may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the Department pursuant to this Disclosure Certificate. Initially, the Department will serve as its own dissemination agent.

SECTION 8. *Amendment; Waiver*. The Department may amend this Disclosure Certificate, and any provision of this Disclosure Certificate may be waived, provided that all of the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Sections 3(a), 4, 5(a) or (b), or 8, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an obligated person with respect to the Bonds, or the type of business conducted;

(b) The undertakings contained in this Disclosure Certificate, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Owners of the Bonds in the same manner as provided in the Indenture for amendments to the Indenture with the consent of Owners, or (ii) does not, in the opinion of the Trustee or nationally recognized bond counsel, materially impair the interests of the Owners or Beneficial Owners of the Bonds. The Department also may amend this Disclosure Certificate without approval by the Owners of the Bonds to the extent permitted by rule, order or other official pronouncement (or consistent with any interpretive advice or no-action positions of staff) of the Securities and Exchange Commission.

In the event of any amendment or waiver of a provision of this Disclosure Certificate, the Department shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the Department. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(b), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

SECTION 9. *Additional Information*. Nothing in this Disclosure Certificate shall be deemed to prevent the Department from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the Department chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the Department shall have no obligation under this Certificate to update such information or include it any future Annual Report or notice of occurrence of a Listed Event.

SECTION 10. *Default*. In the event of a failure of the Department to comply with any provision of this Disclosure Certificate, the Trustee may (and, at the request of the Owners of at least 50% in aggregate principal amount of Outstanding Bonds, shall), or any Owner or Beneficial Owner of the Bonds may (unless the Department has so complied within 20 days after written notice from the Trustee, such Owner or Owners, or such Beneficial Owner or Beneficial Owners, as the case may be, of the Department's failure to comply) seek specific performance by court order, to cause the Department to comply with its obligations under this Disclosure Certificate, as the sole remedy. A default under this Disclosure Certificate shall not be deemed a default or an Event of Default under the Indenture.

SECTION 11. *Duties, Immunities and Liabilities of Dissemination Agent*. The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Certificate, and the Department agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, reasonable expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the reasonable costs and expenses (including reasonable attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's default or negligence or willful misconduct. The obligations of the Department under this Section shall survive resignation or removal of the Dissemination Agent and termination of this Disclosure Certificate.

SECTION 12. *Beneficiaries*. This Disclosure Certificate shall inure solely to the benefit of the Owners and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity.

Date:

DEPARTMENT OF WATER RESOURCES

By: _____
Name:
Title:

EXHIBIT A TO CONTINUING DISCLOSURE CERTIFICATE

Notice to Repositories of Failure to File Annual Report

Name of Issuer:	State of California Department of Water Resources
Name of Bond Issue:	Department of Water Resources Power Supply Revenue Bonds, Series 2008K
Date of Issuance:	_____, 2008

NOTICE IS HEREBY GIVEN that the Department has not provided an Annual Report with respect to the above-named Bonds as required by Section 3 of the Continuing Disclosure Certificate dated _____, 2008 of the Department. The Department anticipates that the Annual Report will be filed by _____.

Dated:_____

STATE OF CALIFORNIA
DEPARTMENT OF WATER RESOURCES

By: _____

cc: Trustee
Co-Trustee

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