Department of Water Resources
Electric Power Fund
Financial Statements

For the years ended June 30, 2004 and 2003

Department of Water Resources Electric Power Fund
Index

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Report of Independent Auditors

The Director of the State of California
Department of Water Resources

In our opinion, the accompanying statements of net assets and the related statements of revenues, expenses and changes in net assets and of cash flows present fairly, in all material respects, the financial position of the Department of Water Resources Electric Power Fund (Fund), a component unit of the State of California, as of June 30, 2004 and 2003, 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 as of June 30, 2004 and 2003, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2004, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with laws, regulations, contracts and grant agreements and other matters for the year ended June 30, 2004. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis presented on pages 3 through 10 are 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

November 15, 2004

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 (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 activities 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 activities presents all of the current year's revenues and expenses. The final required statement is the statement of cash flows. This statement reports cash receipts, disbursements and the net change in cash resulting from three principal types of activities; operating activities, financing activities and investing activities. 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.

HISTORY AND FINANCING

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. DWR is entitled to recover revenue requirements for authorized activities, including but not limited to debt service, the costs of power purchases, administrative costs and reserves.

In November 2002, DWR completed the issuance of $11.3 billion in revenue bonds. The proceeds of the bond issues, along with the cash and investments in the Fund, were used to repay the outstanding balance of a $4.3 billion term loan from a financial consortium, repay $6.2 billion in advances from the State's General Fund with interest, and establish separate accounts in the Fund as required by the Bond Indenture. Sources and uses of funds from the issuance of the revenue bonds were as follows:

Sources of funds:		
Proceeds from issuance of debt, including premium and accrued interest	$	11,675
Cash balance at time of issuance of bonds		2,102
	$	13,777

Uses of funds:		
Repay General Fund and term loan, including accrued interest	$	10,100
Pay costs of issuance, underwriters' discounts, and bond insurance premiums		286
Establish specific accounts as required by the Bond Indenture:		
Operating and Priority Contract Accounts		1,424
Operating Reserve Account		777
Bond Charge Collection and Bond Charge Payment Accounts		263
Debt Service Reserve Account		927
	$	13,777

TRANSITION OF CERTAIN RESPONSIBILITIES TO IOUS, DECREASE IN REQUIRED ACCOUNT BALANCES, AND IMPLEMENTATION OF $1 BILLION BILL CREDIT

On January 1, 2003, DWR transitioned total responsibility for the purchase of short-term power (residual net short) to the IOUs. DWR also transferred the scheduling, dispatch, and certain other administrative functions for the long-term contracts to the IOUs. However, DWR retains the legal and financial responsibility for the long-term contracts until such time as there is complete assignment of the contracts and release of DWR.

While responsible for procurement of the residual net short, DWR was required under the terms of the Bond Indenture to establish its revenue requirements to maintain a minimum Operating Account balance of $1 billion. After DWR transitioned responsibility for the residual net short to the IOUs, the required minimum Operating Account balance for calendar 2003 was reduced to $348 million.

In July 2003, based on the impact of the 1) ability to reduce reserves, 2) collection of past due amounts from PG&E, 3) increases in costs, and 4) greater than anticipated cash balances, DWR decreased its 2003 Revenue Requirement by $1 billion. The PUC ordered the implementation of the revised revenue requirement through bill credits to the customers of the IOUs. The bill credits were fully applied by November 2003.

STATEMENT OF NET ASSETS

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

	2004	2003	2002
Cash and investments	$ -	$ -	$ 2,119
Restricted cash and investments:			
Operating and priority contract accounts	1,320	1,261	-
Bond charge collection and bond charge payment accounts	539	385	-
Other investments	33	37	10
Recoverable costs, current portion	656	1,129	1,318
Other current assets	15	36	33
Long-term restricted cash and investments	1,522	1,704	-
Note receivable, net of current portion	104	-	-
Recoverable costs, net of current portion	7,745	7,568	7,263
Total assets	$ 11,934	$ 12,120	$ 10,743
Long-term debt, including current portion	$ 11,414	$ 11,636	$ 10,345
Other current liabilities	520	484	398
Total capital and liabilities	$ 11,934	$ 12,120	$ 10,743

Cash and Investments and Restricted Cash and Investments

Prior to the issuance of the revenue bonds in November 2002, all cash and investments were maintained in one account. As required by the Bond Indenture, separate restricted cash and investments accounts were established when the bonds were issued. The accounts are classified as current assets, except the Operating Reserve Account and Debt Service Reserve Account which are classified as long-term assets.

The changes in the cash and investments and restricted cash and investments accounts due to the bond issuance are described in the preceding section on History and Financing.

The $163 million net decrease in the Operating and Priority Contract Accounts from the date of the issuance of the bonds through June 30, 2003, reflects normal operating activity.

The Operating and Priority Contract Accounts had a net increase of $59 million in 2004. The $1 billion bill credit, net of the associated collection of $539 million of past due amounts from Pacific Gas & Electric Company (PG&E) and the $147 million transfer from the Operating Reserve, decreased the cash balance by approximately $314 million. This net reduction was offset by the collection of $182 million from energy settlements, an additional $35 million in transfers from the Operating Reserve, and an increase from normal operations of $156 million, attributable to marginal net revenue from the sale of more power than originally anticipated.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $122 million from the date of bond issuance to June 30, 2003. The increase in the balances was expected in anticipation of the first bond principal payment which was made in May 2004. The accounts increased an additional $154 million in 2004, in anticipation of the $388 million principal payment due in May 2005.

From the dates of issuance of the revenue bonds through June 30, 2004, the balances in each of the restricted cash and investments accounts met or exceeded balances required by the Bond Indenture.

Other Investments

DWR purchases natural gas as fuel for the production of power under the terms of certain long-term power purchase contracts. In fiscal 2003, DWR opened a brokerage account with a national brokerage firm in order to hedge natural gas costs. Assets in this account are classified as other investments on the Statements of Net Assets.

The balance of other investments at June 30, 2004 is comparable to that at June 30, 2003. At June 30, 2004, the account consists of money market obligations and government bonds valued at $21 million and financial futures and options valued at $12 million. At June 30, 2004, DWR has open positions with an unrealized marked-to-market value decrease of $4 million reflected in the account balance.

Long-Term Restricted Cash and Investments

The $182 million decrease in long-term restricted cash and investments occurs solely in the Operating Reserve Account at June 30, 2004, and is a function of reduced revenue requirements. The $595 million balance in the Operating Reserve Account at June 30, 2004 is determined in accordance with the bond indenture and is equal to twelve percent of projected annual operating expenses of the Fund for calendar year 2004. There was no change in the $927 million balance of the Debt Service Reserve Account in 2004. During the year ended June 30, 2004, $600 million of the amount on deposit in the Debt Service Reserve Account was reinvested from the State of California Pooled Money Investment Account to investment in four guaranteed investment contracts and one forward purchase agreement with financial institutions.

Recoverable Costs

The current portion of recoverable costs reflects billings to IOU customers that have not yet been collected and amounts due in the next year from the El Paso Corporation energy settlement. The current portion of recoverable costs decreased $189 million during the year ended June 30, 2003, primarily due to the IOUs payment of past due amounts for imbalance energy supplied through the California Independent System Operator market. The current portion of recoverable costs decreased $473 million in the year ended June 30, 2004, primarily due to the collection of past due amounts owed by PG&E.

Long-term recoverable costs consist of costs that are recoverable through future billings. The majority of the $305 million increase during the year ended June 30, 2003 is associated with costs related to the issuance of the revenue bonds. The majority of the $177 million increase during the year ended June 30, 2004 is attributable to the $1 billion bill credit to the customers of the IOUs, offset by the net amount ($433 million) of Bond Charge revenue in excess of interest expense, and amounts earned from energy settlements ($248 million).

Long-Term Debt

Long-term debt increased by $1.291 billion in the year ended June 30, 2003. DWR issued $11.264 billion in revenue bonds which, after using the proceeds to retire General Fund Advances and a term loan, increased debt by $1.575 billion. Other factors affecting the change in debt during the year ended June 30, 2003 are the accrual of $124 million interest on the General Fund Advances prior to their retirement, a $385 million payment on the term loan and $25 million amortization of premium.

The $222 million decrease in long-term debt in the year ended June 30, 2004 is attributable to $180 million in revenue bond principal payments and $42 million amortization of premium.

Other Current Liabilities

Accounts payable at June 30, 2004, 2003 and 2002, are comparable and reflect one month's accrual for power purchases, as payments are normally made on the 20th of the month following purchase.

Accrued interest payable increased $68 million during the year ended June 30, 3003. Accrued interest payable of $69 million at June 30, 2003, represents accrued interest due on the revenue bonds and accrued net scheduled payments on the related swaps. Accrued interest payable at June 30, 2002 of $1 million reflects two days of accrued interest expense for the term loan. Accrued interest due to the General Fund at June 30, 2002, is included in General Fund Advances.

Accrued interest payable at June 30, 2004 is comparable to that at June 30, 2003 as there was only a one percent decrease during 2004 in the principal amount of bonds outstanding.

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):

	2004	2003	2002
Revenues:			
Power charges and surplus sales	$ 4,308	$ 4,517	$ 4,139
Bond charges	800	407	-
Interest income	95	61	102
Total revenues	5,203	4,985	4,241
Expenses:			
Power purchases	5,146	4,517	4,742
Energy settlements	(248)	-	-
Interest expense	422	444	562
Other expenses	59	328	73
Deferral of recoverable costs	(176)	(304)	(1,136)
Total expenses	5,203	4,985	4,241
Net income	-	-	-
Net assets, beginning of year	-	-	-
Net assets, end of year	$ -	$ -	$ -

Power Charges and Surplus Sales

The cost of providing energy is recoverable primarily through power charges to IOU customers and certain customers of "direct access" Electric Service Providers (ESPs), as well as from surplus sales of energy and gas. 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. Since January 1, 2003, DWR has also received 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.

Power charges and surplus sales increased by $378 million in 2003 as compared to 2002, a 9% increase. This increase is primarily attributable to an 8% increase in power delivered during fiscal year 2003, and increased revenue from surplus sales.

Power charges and surplus sales decreased by $209 million in 2004 as compared to 2003. The overall reduction is attributable to recording the $1 billion bill credit as a reduction in power charge revenue. If there had been no bill credit in fiscal 2004, power charge and surplus sales would have been $5.310 billion. After adjusting fiscal 2003 for the impact of the $113 million rebate for the "20-20 Energy Rebate Program", 2004 revenues, excluding the bill credit, increased by 15% over 2003 revenues. This increase is primarily attributable to a 13% increase in power delivered in 2004 as compared to 2003.

Bond Charges

The bond charge was established in November 2002 to pay for debt service on the revenue bonds. Bond charges are determined by applying a CPUC adopted rate to the total megawatt hours of power delivered to each IOU's customers and certain ESP customers. Bond charges earned through June 30, 2003, and for the year ended June 30, 2004 were $407 million and $800 million, respectively, and are comparable to forecasted debt service requirements.

Interest Income

The $41 million decrease in interest income between the years ended June 30, 2003 and 2002, is directly related to the change in rates available for short-term investments between the two years.

The $34 million increase in interest income in 2004 is primarily attributable to the receipt of $38 million for interest on past due amounts owed by PG&E, as ordered by a CPUC decision issued in January, 2004.

Power Purchases

DWR power costs are $225 million less in fiscal 2003 than in fiscal 2002, even though DWR purchased eight percent more power in 2003. The increased power purchases are attributable to a 50% increase in volume from long-term contracts as new plants financed by the long-term contracts began production. The increase in the volume of power purchased under the long-term contracts was offset by the successful transition of the residual net short procurement responsibility to the IOUs in January 2003. The average cost per MWh for both long-term contract power and short-term power is approximately $10 per MWh less in fiscal 2003 than in fiscal 2002.

DWR power costs are $629 million higher in fiscal 2004 than in fiscal 2003. This 14% increase reflects the 13% increase in energy volumes purchases during 2004 at marginally higher costs than in 2003. The increase in power purchased is attributable to 1) power from new plants coming on line under the terms of the original power contracts, 2) increased use of DWR dispatchable contracts by the IOUs because of more downtime for an IOU nuclear facility than was originally forecast, and 3) higher market clearing prices which lead to the additional use of DWR dispatchable contracts for sale in the wholesale market.

Energy Settlements

Energy settlements received, including those from complex regulatory proceedings before the Federal Energy Regulatory Commission (FERC) arising from events in California energy markets in 2001, are recorded as a decrease in operating expenses. Substantially the entire 2004 amount is attributable to a settlement between various parties and El Paso Corporation. Under the terms of the El Paso settlement, DWR received $225 million in June 2004, including a note receivable with a discounted value of $115 million under which DWR will receive semiannual payments over the next 20 years. The remaining amounts earned in 2004 are attributable to settlements with two other companies.

Interest Expense

Interest expense incurred during fiscal 2003 is $118 million less than in fiscal 2002. While total borrowings increased during 2003, the overall interest rate for the revenue bonds issued in November 2002 is 4.8% and is less than the interest rates for both the General Fund advances and the term loan, which were 5.3% and 5.7%, respectively.

Interest expense in fiscal 2004 is $23 million less than in fiscal 2003. This is expected as the bonds were outstanding for all fiscal 2004, while for a portion of fiscal 2003, interest expense includes the higher rates for the General Fund Advances and term loan.

Other Expenses

The costs incurred for issuance of the revenue bonds for the year ended June 30, 2003 and 2002, are $257 million and $26 million, respectively. The expense for the year ended June 30, 2003, includes payments totaling $236 million for credit enhancement fees, including bond insurance premiums, and underwriters' fees. There are no costs in 2004 for the issuance of revenue bonds.

Administrative expenses are $24 million higher in fiscal 2003 than in fiscal 2002 because of increased expenditures for contract renegotiation, legal costs, and one-time costs incurred in the transition of certain power procurement responsibilities to the IOUs.

Administrative expenses are $12 million less in 2004 than in 2003. Costs incurred for contract renegotiation and litigation decreased during the year, and the IOUs have assumed more administrative responsibilities for the contracts since the transition of the residual net short in January 2003.

Deferral of Recoverable Costs

The individual components of the deferral of recoverable costs are as follows:

	2004	2003	2002
Operations	$ 649	$ 71	$ 650
Debt service and related costs	(473)	233	486
	$ 176	$ 304	$ 1,136

Operations
The decrease in the deferral of recoverable costs in fiscal 2003 as compared to fiscal 2002 is attributable to reduced cost of purchased power between the two fiscal years. For the first quarter of fiscal 2002, the cost of power continued to exceed the revenue received from ratepayers, and the Fund used borrowings from the $4.3 billion term loan to pay for operating costs. In 2003, the deferral represents less than 2% of total operating costs.

The increase in deferral of recoverable costs in fiscal 2004 as compared to fiscal 2003 is primarily attributable to the $1 billion bill credit. This is offset by the $248 million of energy settlements, and other revenue received in excess of the cost of purchased power and administrative costs.

Debt Service and Related Costs
In fiscal 2002 the bond charge had not yet been established to offset debt service and related costs. Therefore, all interest expense and costs incurred for issuance of revenue bonds were deferred to the extent they exceeded interest income. In fiscal 2003, with the addition of the bond charge revenue, the amount of costs deferred was reduced. The net amount deferred consists of costs incurred for issuance of revenue bonds that were financed through bond proceeds.

In fiscal 2004, the recovery of $473 million is primarily attributable to 1) a full year's collection of bond charges, 2) use of $180 million of the bond charge proceeds to retire principal on debt, 2) and collection of bond charges in the Bond Charge Payment Account in anticipation of the May 2005 principal payment of $388 million.

FUTURE OPERATIONS

DWR will administer the Fund at least until such time as the revenue bonds are completely retired. Revenue requirements for the repayment of the bonds will be determined at least annually and submitted to the 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 ESPs such that the Fund will always have monies to redeem the bonds when due.

DWR has the authority to administer all power supply contracts entered into before December 31, 2002, for the life of the contracts. The last of the contracts expires in 2013. Revenue requirements for the payment of energy purchased under the contracts will be determined at least annually and submitted to the CPUC. Under the terms of the rate agreement between the CPUC and DWR, the CPUC is required to implement power charges such that the Fund will receive necessary monies to meet its revenue requirements.

The financial responsibility for the contracts may be transferred to the IOUs as part of a complete assignment of the contracts and release of DWR. However, there are a number of issues to be addressed, including IOU creditworthiness and counterparty approval, before the contracts can be assigned.

Department of Water Resources Electric Power Fund
Statements of Net Assets
June 30, 2004 and 2003 (in millions)

	2004	2003
Assets		
Current assets:		
Restricted cash and investments:		
Operating and Priority Contract Accounts	$ 1,320	$ 1,261
Bond Charge Collection and		
Bond Charge Payment Accounts	539	385
Other investments	33	37
Recoverable costs, current portion	656	1,129
Interest receivable	15	15
Due from other funds	-	21
Total current assets	2,563	2,848
Long-term assets:		
Restricted cash and investments:		
Operating Reserve Account	595	777
Debt Service Reserve Account	927	927
Note receivable, net of current portion	104	-
Recoverable costs, net of current portion	7,745	7,568
Total long-term assets	9,371	9,272
Total assets	$ 11,934	$ 12,120
Capitalization and Liabilities		
Capitalization:		
Long-term debt:		
Revenue bonds	$ 10,982	$ 11,414
Total capitalization	10,982	11,414
Current liabilities:		
Current portion of long-term debt	432	222
Accounts payable	452	415
Accrued interest payable	68	69
Total current liabilities	952	706
Commitments and Contingencies (Note 7)		
Total capitalization and liabilities	$ 11,934	$ 12,120

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, 2004 and 2003 (in millions)

	2004	2003
Operating revenues:		
Power charges	$ 3,887	$ 4,418
Surplus sales	421	99
Total operating revenues	4,308	4,517
Operating expenses:		
Power purchases	5,146	4,517
Energy settlements	(248)	-
Administrative expenses	59	71
Deferral of recoverable operating costs	(649)	(71)
Total operating expenses	4,308	4,517
Income from operations	-	-
Bond charges	800	407
Interest income	95	61
Costs incurred for issuance of revenue bonds	-	(257)
Interest expense	(422)	(444)
(Recovery) deferral of recoverable debt service and related costs	(473)	233
Net income	-	-
Net assets, beginning of year	-	-
Net assets, end of year	$ -	$ -

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

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the years ended June 30, 2004 and 2003 (in millions)

	2004	2003
Cash flows from operating income:		
Receipts:		
Power charges	$ 4,457	$ 4,766
Surplus sales	379	-
Energy settlements	133	-
Payments for power purchases and other costs	(5,144)	(4,611)
Net cash (used in) provided by operating activities	(175)	155
Cash flows from non-capital financing activities:		
Proceeds from revenue bonds, net of underwriters' fees and bond insurance premiums	-	11,437
Receipts from customers for bond charges	776	352
Bond payments	(180)	-
Payments on term loan	-	(3,849)
Payments to State of California General Fund	-	(6,620)
Interest payments	(465)	(282)
Net cash provided by non-capital financing activities	131	1,038
Cash flows from investing activities:		
Investments purchased	(20)	(40)
Interest received on investments	95	78
Net cash provided by investing activities	75	38
Net increase in cash and investments	31	1,231
Restricted (2004) and unrestricted (2003) cash and investments, beginning of year	3,350	2,119
Restricted cash and investments, end of year	$ 3,381	$ 3,350
Reconciliation of operating income to net cash (used in) provided by operating activities:		
Income from operations	$ -	$ -
Changes in net assets and liabilities to reconcile operating income to net cash used in operations:		
Recoverable costs	(233)	157
Due from other funds	21	(20)
Accounts payable	37	18
Total adjustments	(175)	155
Net cash (used in) provided by operating activities	$ (175)	$ 155

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

1. Reporting Entity

Background

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) (Fund), administered by the Department of Water Resources (DWR), was established in January 2001 through legislation adding Division 27 to the California Water Code. Division 27 of the California Water Code includes the following powers and requirements:

- Authorizes DWR to act on behalf of the State of California to secure necessary power supplies for resale to customers of Pacific Gas & Electric Company (PG&E), Southern California Edison Company (SCE), and San Diego Gas & Electric Company (SDG&E) (collectively referred to as the investor owned utilities or IOUs).
- Prohibits DWR from entering into new power purchase agreements after December 31, 2002, but allows DWR to continue to administer existing contracts.
- Requires DWR to retain title to all power sold, but authorizes DWR to enter into service agreements with the IOUs for transmission, distribution, billing and collection services.
- Authorizes DWR and the California Public Utilities Commission (CPUC) to enter into an agreement with respect to charges to provide for recovery by DWR of its revenue requirements.
- Authorizes DWR to issue bonds payable solely from the Fund.
- Entitles DWR to recover its revenue requirements incurred in connection with its authorized activities, including debt service, the costs of power purchases, administrative costs and reserves.

DWR began selling electricity to approximately ten million IOU retail customers in California in January 2001. DWR purchases power from wholesale suppliers under long-term contracts and, through December 31, 2002, in short-term and spot market transactions. 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 CPUC. DWR initially financed its power purchases with advances from the General Fund of the State of California, loans from financial institutions, and revenues from power sales to customers. The advances from the General Fund and the remaining balance of the loans from financial institutions were repaid from the proceeds of revenue bonds issued in October and November 2002.

2. Summary of Significant Accounting Policies

Basis of Presentation

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

The financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the business-type activities and major funds of the State of California that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position of the State of California as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows, where applicable, for the year 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 investments, for purposes of the statements of cash flows, include cash on hand and short-term investments, specifically deposits in the State of California Investment Pooled Money Investment Account-Surplus Money Investment Fund (SMIF) and certain long-term investments.

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 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 Investments
The Fund maintains a brokerage account with a national brokerage firm in order to take positions in futures and options for the hedging of natural gas fuel costs. Natural gas future and option agreements are reported at fair value on the statement of net assets. 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. The Fund is exposed to additional fuel price risk if the counterparties default or if the future or option agreements are terminated. The Fund's position underlying open natural gas future and option agreements totaled $12 million and $16 million at June 30, 2004 and 2003, respectively. It is possible that the market price before or at the specified time to purchase natural gas may be lower than the price at which the Fund is committed to buy. This would reduce the value of the contract. The Fund could sell the contract at a loss, or if it were to continue to hold the contract, the Fund may make a termination payment to the counterparty to cancel its obligation under the contract and then buy natural gas on the open market.

The brokerage firm 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 $20 million at both June 30, 2004 and 2003 and the investments in government bonds amounted to $1 million at both June 30, 2004 and 2003.

Revenues and Recoverable Costs
Customer charges are separated into two primary components, power charges and bond charges. Power charge revenues recover the cost of power purchases, administrative costs 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 "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 customers. Costs are recovered over a period of time as determined by DWR's revenue requirement process.

For the year ended June 30, 2003, power charges were reduced by $113 million for rebates given to the customers of the IOUs under the Governor's "20-20 Energy Rebate Program," which, during the summer peak demand months, generally granted the customers a 20% reduction in their monthly power bills if they reduced their energy use by 20% from the same period in the previous year. These reductions extend the period of time over which the Fund will recover its costs for that period.

During the year ended June 30, 2004, power charges were reduced by $1.002 billion in the form of bill credits given to the customers of the IOUs through the CPUC's implementation of DWR's 2003 Supplemental Revenue Requirement. This reduction was based on the net impact of 1) the ability to reduce reserves as allowed under the Bond Indenture, 2) the receipt of cash for past due amounts being held in trust by PG&E, 3) increases in costs, and 4) a greater than anticipated Operating Account balance at January 1, 2003 .

Surplus sales represent DWR's 1) allocated portion of the IOU's total surplus energy sales and 2) the sale of gas not needed for the generation of power. Effective January 1, 2003, revenue from the sale of excess energy by the IOUs is to be 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.

Amounts that have been earned but not collected are recorded as the current portion of recoverable costs. Costs that are recoverable through future billings and collection of finalized energy settlements are recorded as long-term assets.

New Accounting Pronouncement
For the year ended June 30, 2004, DWR implemented the provisions of Government Accounting Standards Board Statement No. 40 (GASB 40), *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*. GASB 40 requires disclosure of credit risk, concentration of credit risk, interest rate risk, and foreign currency risk and modifies previous custodial credit risk disclosure requirements.

For the years ended June 30, 2004 and 2003 (in millions)

3. Restricted Cash and Investments

The State of California has a deposit policy for custodial credit risk. As of June 30, 2004, $25 million of the Fund's cash deposits of $50 million was exposed to custodial credit risk as follows:

Institution	Amount	Custodial Credit Risk
Prime Value Obligations Fund Institutional Shares	$ 20	Insured
U.S. Bank	5	Uninsured and uncollateralized
	$ 25	

As of June 30, 2004, the Fund had the following investments:

Investment	Maturities	Fair Value
State of California Pooled Money Investment Account - State Money Investment Fund	6.5 months average	$ 2,751
Guaranteed investment contracts	May 1, 2022	500
Forward purchase agreement	November 1, 2004	100
Natural gas futures and options	3 months average	12
Other	5 year average	1
Total		$ 3,364

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.

For the years ended June 30, 2004 and 2003 (in millions)

The Fund's investments in the guaranteed investment contract and forward purchase agreement are rated as follows, by Standard & Poors (S&P) and Moody's, respectively, at June 30, 2004:

	Amount	S & P	Moody's
GIC Providers			
FSA	$ 100	AAA	Aaa
XL Capital	150	AAA	Aaa
Royal Bank of Canada	100	AA-	Aa2
Sun America	150	AAA	Aaa
	$ 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 1.5% and 1.7% at June 30, 2004 and 2003, respectively. For the years ended June 30, 2004 and 2003, interest earned on the deposit in PMIA was $50 million and $61 million, respectively.

Interest on the GICs is paid semi-annually at interest rates ranging from 5.2% to 5.47%. Interest earned on the GICs as of June 30, 2004 was $3 million. 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 4.710%, as specified in the Reserve Fund Forward Purchase and Sale Agreement, dated May 1, 2004. The reinvested securities are to mature every six months. As of June 30, 2004 interest earned on the FPA was $1 million.

For the years ended June 30, 2004 and 2003 (in millions)

4. Long-Term Debt

The following activity occurred in the long-term debt accounts during the years ended June 30, 2004 and 2003:

	General Fund Advances	Term Loan	Revenue Bonds	Unamor-tized Premium	Total Revenue Bonds	Total Long-term Debt
Balance, June 30, 2002	$ 6,496	$ 3,849	$ -	$ -	$ -	$ 10,345
Accrued interest	124	-	-	-	-	124
Payments	-	(385)	-	-	-	(385)
Sale of revenue bonds	(6,620)	(3,464)	11,264	397	11,661	1,577
Amortization of premium	-	-	-	(25)	(25)	(25)
Balance, June 30, 2003	-	-	11,264	372	11,636	11,636
Payments	-	-	(180)	-	(180)	(180)
Amortization of premium	-	-	-	(42)	(42)	(42)
Balance, June 30, 2004	-	-	11,084	330	11,414	11,414
Less current portion	-	-	388	44	432	432
	$ -	$ -	$ 10,696	$ 286	$ 10,982	$ 10,982

In fall 2002, DWR issued $11.264 billion of revenue bonds. The proceeds of the bonds, along with the cash balance in the Fund at the date of issuance, were used to repay previously incurred debt (including General Fund Advances and a term loan provided by outside financial institutions) and fund restricted cash and investment accounts as required by the bond indenture.

The average interest rate for the term loan was 5.1% for the period from July 1, 2002, until the loan was repaid on October 30, 2002. Interest expense on the term loan was $60 million for the year ended June 30, 2003. The average interest rate on the General Fund Advances approximated 5.31% until the advances were repaid in November 2002. Interest expense on the General Fund advances was $124 million for the year ended June 30, 2003.

For the years ended June 30, 2004 and 2003 (in millions)

The revenue bonds, all of which except Series E are tax-exempt, consist of the following at June 30, 2004:

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amounts Outstanding
A	3.0-6.0%	2022	2012	$ 6,314
B	Variable	2020	Callable	1,000
C	Variable	2022	Callable	2,750
D	Variable	2022	Callable	500
E	3.6-4.3%	2006	Not callable	520
				11,084
Plus unamortized bond premium				330
Less current maturities				(432)
				$ 10,982

Series B and C are variable rate bonds and have daily and weekly rate reset modes, respectively, 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 fiscal 2007 to 2022. Total interest cost, including amortization of premium, for the years ended June 30, 2004 and June 30, 2003 for all revenue bonds were $422 and $260 million, respectively. The interest rates for the variable debt for the year ended June 30, 2004, ranged from 0.40% to 1.38%. The interest rates for the variable debt from the date of issuance through June 30, 2003, ranged from 0.70% to 1.80%.

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 Series B and $1.75 billion of Series C 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, 2004. The letters of credit expire in fiscal 2006. The Fund pays fees of 0.85% per annum on the stated amount of the letters of credit.

The remaining $1 billion of Series C bonds is 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. There are no outstanding amounts due under liquidity facilities at June 30, 2004. Three liquidity facilities backing $300 million in Series C bonds expire in fiscal year 2006, and two liquidity facilities underlying $700 million of Series C bonds expire in fiscal year 2010. The Fund pays fees of 0.22% to 0.37% per annum under the liquidity facilities.

For the years ended June 30, 2004 and 2003 (in millions)

Future payment requirements on the revenue bonds are as follows at June 30, 2004:

Fiscal Year	Principal	Interest [1]	Total
2005	$ 388	$ 397	$ 785
2006	409	381	790
2007	427	364	791
2008	449	344	793
2009	471	322	793
2010-2014	2,750	1,299	4,049
2015-2019	3,580	646	4,226
2020-2022	2,610	116	2,726
	$ 11,084	$ 3,869	$ 14,953

[1] Variable portion of interest cost calculated using the June 30, 2004 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 are summarized in the following table:

Outstanding Notional Amount at June 30, 2004	Fixed Rate Paid by Fund	Variable Rate Received by the Fund [1]	Fair Values at June 30, 2004	Swap Termination Date	Counterparty Credit Ratings (Moody's, Fitch, S&P)
$ 94	2.914%	67% of LIBOR	$ (1)	May 1, 2011	Aaa, AAA, AAA
234	3.024%	67% of LIBOR	(2)	May 1, 2012	Aaa, AAA, AAA
200	3.405%	BMA	(1)	May 1, 2013	Aa3, A+, A+
100	3.405%	BMA	-	May 1, 2013	Aa3, AA-, A+
30	3.405%	BMA	-	May 1, 2013	Aa3, AA-, A+
194	3.204%	67% of LIBOR	2	May 1, 2014	Aa1, AA-, AA-
174	3.280%	67% of LIBOR	(2)	May 1, 2015	Aaa, AAA, AAA
202	3.342%	67% of LIBOR	2	May 1, 2016	Aa2, AA, AA-
202	3.389%	67% of LIBOR	3	May 1, 2017	Aa3, AA-, A+
$ 1,430			$ 1		

[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.

Fair Value: The reported fair values from the table above were provided by the counterparties, using the par value, or marked-to-market, method.

Credit Risk: As of June 30, 2004, the Fund was not exposed to significant credit risk because the swaps had small positive and negative fair values. However, should interest rates increase and the fair values become more positive, the Fund would be exposed to credit risk in the amount of the swaps' fair value. DWR has a total of nine swap agreements with six different counterparties. Three swaps, approximating 35 percent of the total notional value are with one counterparty with a credit rating of Aaa/AAA/AAA. Of the remaining swaps, two are held with a single counterparty, approximating 21 percent of the outstanding notional value. That counterparty has credit ratings of Aa3/AA-/A+. The remaining four swaps are with separate counterparties, all having Aa3/A+/A+ ratings or better.

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. Should the relationship between LIBOR and the tax-exempt market change and move to convergence, or should DWR's bonds trade at levels worse (higher in rate) in relation to the tax-exempt market, DWR's all-in costs would increase. As of June 30, 2004, the variable rate on DWR's hedged bonds ranged from .68% to 1.33%, while 67% of LIBOR received on the swap was equal to .91%.

Termination Risk: DWR's swap agreements do not contain any out-of-the-ordinary termination events 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 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, 2004, 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):

Fiscal Year Ending June 30	Variable Rate Bonds Principal	Variable Rate Bonds Interest	Interest Rate Swaps, Net	Total
2005	$ -	$ 15	$ 33	$ 48
2006	-	15	33	48
2007	-	15	33	48
2008	-	15	33	48
2009	-	15	33	48
2010-2014	852	64	142	1,058
2015-2017	578	12	29	619
	$ 1,430	$ 151	$ 336	$ 1,917

6. Retirement Plan

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, 2004 and 2003, 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.

7. Commitments and Contingencies

Litigation

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

In 2002, two energy suppliers petitioned the Federal Energy Regulatory Commission (FERC), contending that they are owed $58 million by DWR for power DWR purchased in the last half of January 2001 in the California Independent System Operator (ISO) market. DWR paid all amounts billed by the ISO, but the ISO distributed DWR's January payment on a pro rata basis to all market participants for the entire month, leaving energy suppliers with less than full payment for power purchased by DWR during the last half of the month. In November 2002, FERC issued an order finding that the ISO had misapplied the payment it received from DWR and directed the ISO to reallocate and disburse DWR's January payment to those that supplied power during the last half of the month. In May 2004, FERC deferred final resolution of this matter until such time as the amount, if any, of FERC mandated refunds by the two energy suppliers to California parties, including DWR, has been determined.

In May 2004, FERC issued an order requiring DWR to pay approximately $270 million, the amount by which its sales to the ISO exceeded allowed mitigated market clearing prices, even though DWR sold the energy to the ISO at the same price DWR paid for the energy. DWR expects that any amount due under this order will be offset by FERC mandated refunds to DWR.

There are a number of lawsuits and regulatory proceedings in which DWR is not a party but may be affected by the result. In one case, California Power Exchange Corporation (CalPX), certain IOUs and others have brought suit against the State of California claiming that the State's commandeering of CalPX's block forward contracts after CalPX filed bankruptcy in early 2001 was unconstitutional. The plaintiffs argue that they are entitled to damages of $1.1 billion, which is their estimation of the fair value of the block forward contracts at the time of commandeering. Under the block forward contracts, which expired in December 2001, the Fund paid approximately $350 million for energy provided by the contracts.

Management believes that the existing lawsuits and regulatory proceedings will be resolved in the next fiscal year. Because of the early stage of the legal and regulatory proceedings, the ultimate outcome of these matters cannot be presently determined.

For the years ended June 30, 2004 and 2003 (in millions)

Other Contingencies
The Fund is self-insured for most risks, including general liability and workers' compensation. Management believes that any costs associated with such 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 ten years. Payments made under these contracts approximated $4.1 billion and $3.7 billion for the years ended June 30, 2004 and 2003, respectively.

The remaining amounts of fixed obligations under the contracts as of June 30, 2004, are as follows:

For the Year Ending June 30,	Fixed Obligation
2005	$ 3,144
2006	2,783
2007	2,525
2008	2,379
2009	2,238
Thereafter	3,443
	$ 16,512

In addition to the fixed costs there are variable costs under several of the contracts. Management projected as of June 30, 2004 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $25 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.

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.

In June 2004, a settlement agreement with El Paso Corporation and affiliates became effective. At that time DWR received $160 million in cash payments, $50 million of which related to a refund of 2004 power purchase costs and is reflected as a reduction of power purchase expense. DWR is scheduled to receive an additional $240 million, with a discounted value of $115 million, in semi-annual installments over the next 20 years.

Also during fiscal 2004, settlement agreements with El Paso Electric Company and Portland General Electric Company were completed in which DWR received $15 million and $6 million, respectively.

In April 2004, a settlement agreement was signed with Dynegy Inc, which became effective October 25, 2004. Under the terms of the settlement's allocation agreement, DWR received approximately $100 million in November 2004.

9. Related Party Transactions

The California State Teachers' Retirement System (STRS), which is part of the California state government, participates in two letters of credit with a financial institution. The total commitment underlying the STRS' participation approximates $177 million and expires on October 30, 2005. There are no outstanding amounts on the letters of credit at June 30, 2004.

During the year ended June 30, 2003 the Fund purchased $6 million of power from and sold $5 million of power to the State Water Resources Development System (System), another enterprise fund administered by DWR. There were no purchases or sales in the year ended June 30, 2004.

Net amounts owed to the Fund by the System were $3 million at June 30, 2003. There are no amounts due to or from other DWR funds at June 30, 2004.

During the year ended June 30, 2003, the Fund advanced $26 million to DWR's internal service fund, which functions as a revolving working capital facility for the Fund. The monies were reimbursed to the Fund in August 2003.