

# Department of Water Resources Electric Power Fund Financial Statements

September 30, 2004



**Department of Water Resources Electric Power Fund  
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# Department of Water Resources Electric Power Fund Management's Discussion and Analysis

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## USING THIS REPORT

This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities and to identify any significant changes in financial position of the Department of Water Resources Electric Power Fund (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 a specified date. The statement of revenues, expenses and changes in net assets presents all of the revenues and expenses for a specified time period. 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.

This report should be read in conjunction with the Fund's June 30, 2004 audited financial statements.

## BACKGROUND

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. On that date, DWR transitioned complete responsibility for the purchase of short-term power 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. DWR is entitled to recover its revenue requirements for authorized activities, including but not limited to debt service, the costs of power purchases, administrative costs and reserves.

# Department of Water Resources Electric Power Fund Management's Discussion and Analysis

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## STATEMENT OF NET ASSETS

The Fund's assets and liabilities as of September 30, 2004 and June 30, 2004 are summarized as follows (in millions):

	September	June
Restricted cash and investments:		
Operating and priority contract accounts	\$ 1,161	\$ 1,320
Bond charge collection and bond charge payment accounts	756	539
Other investments	70	33
Recoverable costs, current portion	705	656
Interest receivable	24	15
Long-term restricted cash and investments	1,522	1,522
Note receivable, net of current portion	104	104
Recoverable costs, net of current portion	7,700	7,745
Total assets	<u>\$ 12,042</u>	<u>\$ 11,934</u>
Long-term debt, including current portion	\$ 11,402	\$ 11,414
Other current liabilities	640	520
Total capital and liabilities	<u>\$ 12,042</u>	<u>\$ 11,934</u>

### Restricted Cash and Investments

The Operating and Priority Contract Accounts had a net decrease of \$159 million in the three months ended September 30, 2004. This decrease is due to 1) a planned decrease in receipts due to a lower revenue requirement, and 2) the cyclical nature of the collection of the energy revenues in relation to the disbursements for the purchases of energy. During the height of summer the Fund was procuring and paying for more energy for the peak demand period, however; due to the normal lag in the collection of revenues, the Fund was still receiving revenues for months in which energy deliveries were less.

The Bond Charge Collection and Bond Charge Payment Accounts increased by \$217 million during the three months ended September 30, 2004. The increase in the balances was expected in anticipation of the \$176 million interest payment due in November 2004 and a \$338 million principal payment due in May 2005.

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

### Other Investments

Other investments consists of a brokerage account with a national brokerage firm in order to hedge natural gas costs for fuel used in the production of power under the terms of certain power purchase contracts.

# Department of Water Resources Electric Power Fund Management's Discussion and Analysis

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Other investments at September 30, 2004 increased by \$37 million since June 30, 2004. Approximately one-half of this increase is due to the increased value of the open positions as a result of the overall increase in natural gas prices. The remaining \$20 million increase was due to additional money invested in the account. At September 30, 2004, the account consists of money market obligations and government bonds valued at \$28 million and financial futures and options valued at \$42 million. At September 30, 2004, DWR has open positions with an unrealized marked-to-market value increase of \$22 million reflected in the account balance.

## **Long-Term Restricted Cash and Investments**

The \$595 million balance in the Operating Reserve Account at both September 30, 2004 and June 30, 2004 is determined in accordance with the bond indenture and represents 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 during the three month period.

## **Recoverable Costs**

The current portion of recoverable costs principally reflects billings to IOU customers that have not yet been collected. The current portion of recoverable costs increased \$52 million during the three months ended September 30, 2004, primarily due to cyclical nature of the revenue collection as the Fund typically has increased sales of power in the summer months.

Long-term recoverable costs consist of costs that are recoverable through future billings. The majority of the \$45 million recovery of costs during the three month period ended September 30, 2004 is associated with the recognition of bond charge revenue at a level to meet both scheduled debt retirement and pay interest expense when due. This is offset by the operating expenses which exceeded operating revenues by \$113 million during the quarter ended September 30, 2004.

## **Long-Term Debt**

Long-term debt decreased by \$12 million in the three month period ended September 30, 2004 due to amortization of the bond premium.

## **Other Current Liabilities**

Accounts payable at September 30, 2004 and June 30, 2004 are comparable and reflect one month's accrual for power purchases.

The \$100 million increase in accrued interest payable is anticipated as the fixed rate bonds provide for semi-annual payments on May 1<sup>st</sup> and November 1<sup>st</sup>, while the variable rate bonds provide for more frequent payments.

# Department of Water Resources Electric Power Fund Management's Discussion and Analysis

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## STATEMENT OF ACTIVITIES

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

	2004	2003
Revenues:		
Power charges and surplus sales	\$ 1,330	\$ 495
Bond charges	243	277
Interest income	25	14
Total revenues	<u>1,598</u>	<u>786</u>
Expenses:		
Power purchases	1,426	1,527
Interest expense	110	105
Other expenses	17	19
Recovery (deferral) of recoverable costs	45	(865)
Total expenses	<u>1,598</u>	<u>786</u>
Net income	-	-
Net assets, beginning of the period	-	-
Net assets, end of period	<u>\$ -</u>	<u>\$ -</u>

### Power Charges and Surplus Sales

Revenues from Power Charges and surplus sales increased by \$835 million in the three month period ended September 30, 2004 compared to the same period in 2003. The revenues through September 30, 2003 reflect recognition of the \$1 billion bill credit to the ratepayers. The remaining \$165 million difference is attributable to a decrease in energy revenues from power sold to IOU customers by DWR in the three months ended September 30, 2004. The volume of power sold in the three month period ended September 30, 2004 is within 1% of that sold in the same period in 2003. However, 2004 remittance rates, which are based of DWR's 2004 revenue requirements, are 12% lower than in 2003. This reduction in rates is attributable to the lower average cost per megawatt hour of power in the DWR contract portfolio in calendar 2004, the impact of energy settlements, and the ability of DWR to reduce cash balances and still remain in compliance with the Bond Indenture requirements.

### Bond Charges

Bond charges earned through September 30, 2004, were \$34 million less than the same period in 2004 even though total power delivered in these two periods was almost the same. The reduction was the result of lower bond charge rate in 2004, based on the DWR 2004 revenue requirements, compared to rates in place for the same period in 2003.

# Department of Water Resources Electric Power Fund Management's Discussion and Analysis

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## Interest Income

The \$11 million increase in interest income in the quarter ended September 30, 2004 as compared to the same period in 2003, is primarily attributable to the investment of a portion of the Debt Service Reserve Account in higher yielding investments. There is now \$600 million invested in guaranteed investment contracts and a forward purchase agreement, rather than the more liquid State of California Pooled Money Investment Account.

## Power Purchases

DWR power costs are \$101 million less in the three months ended September 30, 2004 than in the same period in 2003. Although the volume of DWR's power purchases in the three months ended September 30, 2004 are within 1% of that purchased in the same period in 2003, the average cost of power decreased from approximately \$89 per MWh to \$84 per MWh. This decrease results from changes in the contract portfolio, previous contract renegotiations that are now effective, and reduced costs for energy under the terms of the El Paso Corporation energy settlement.

## Interest Expense

Interest expense incurred during the three month period ended September 30, 2004 is \$5 million more than in the same period in 2003. The increase reflects higher interest rates for variable debt and a lower percentage of LIBOR being received in 2004 than in 2003 for the synthetic interest rate swaps.

## Recovery (Deferral) of Recoverable Costs

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

	2004	2003
Operations	\$ (113)	\$ (1,051)
Debt Service and related costs	158	186
	<u>\$ 45</u>	<u>\$ (865)</u>

### Operations

The deferral of recoverable costs in the three months ended September 30, 2003 is primarily attributable to the \$1 billion bill credit. The \$113 million deferral in the three months ended September 30, 2004 recognizes that DWR has, through the revenue requirement process, reduced power charges and cash balances and still remain in compliance with Bond Indenture requirements.

### Debt Service and Related Costs

The recovery of debt service and related costs are comparable between the three month periods ended September 30, 2004 and 2003, and are comprised solely of the difference between bond charges and interest income less interest expense.

# Department of Water Resources Electric Power Fund Management's Discussion and Analysis

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## 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**  
**September 30, 2004 and June 30, 2004**

**(in millions)**

	September 30, 2004	June 30, 2004
<b>Assets</b>		
Current assets:		
Restricted cash and investments:		
Operating and Priority Contract Accounts	\$ 1,161	\$ 1,320
Bond Charge Collection and Bond Charge Payment Accounts	756	539
Other investments	70	33
Recoverable costs, current portion	705	656
Interest receivable	24	15
Total current assets	<u>2,716</u>	<u>2,563</u>
Long-term assets:		
Restricted cash and investments:		
Operating Reserve Account	595	595
Debt Service Reserve Account	927	927
Note receivable, net of current portion	104	104
Recoverable costs, net of current portion	7,700	7,745
Total long-term assets	<u>9,326</u>	<u>9,371</u>
Total assets	<u>\$ 12,042</u>	<u>\$ 11,934</u>
<b>Capitalization and Liabilities</b>		
Capitalization:		
Long-term debt:		
Revenue bonds	\$ 10,970	\$ 10,982
Total capitalization	<u>10,970</u>	<u>10,982</u>
Current liabilities:		
Current portion of long-term debt	432	432
Accounts payable	472	452
Accrued interest payable	168	68
Total current liabilities	<u>1,072</u>	<u>952</u>
Commitments and Contingencies (Note 5)		
Total capitalization and liabilities	<u>\$ 12,042</u>	<u>\$ 11,934</u>

The accompanying notes are an integral part of these financial statements

**Department of Water Resources Electric Power Fund**  
**Statements of Revenues, Expenses and Changes in Net Assets**  
**For the three months ended September 30, 2004 and 2003**

**(in millions)**

	2004	2003
Operating revenues:		
Power charges	\$ 1,265	\$ 445
Surplus sales	65	50
Total operating revenues	<u>1,330</u>	<u>495</u>
Operating expenses:		
Power purchases	1,426	1,527
Administrative expenses	17	19
Deferral of recoverable operating costs	(113)	(1,051)
Total operating expenses	<u>1,330</u>	<u>495</u>
Income from operations	<u>-</u>	<u>-</u>
Bond charges	243	277
Interest income	25	14
Interest expense	(110)	(105)
Recovery of recoverable debt service and related costs	<u>(158)</u>	<u>(186)</u>
Net income	-	-
Net assets, beginning of the period	-	-
Net assets, end of the period	<u>\$ -</u>	<u>\$ -</u>

The accompanying notes are an integral part of these financial statements

**Department of Water Resources Electric Power Fund**  
**Statements of Cash Flows**

**For the three months ended September 30, 2004 and 2003**

**(in millions)**

	2004	2003
Cash flows from operating income:		
Receipts:		
Power charges	\$ 1,206	\$ 1,290
Surplus sales	87	50
Payments for power purchases and other costs	<u>(1,440)</u>	<u>(1,438)</u>
Net cash used in operating activities	<u>(147)</u>	<u>(98)</u>
Cash flows from non-capital financing activities:		
Receipts from customers for bond charges	233	255
Interest payments	<u>(22)</u>	<u>(12)</u>
Net cash provided by non-capital financing activities	<u>211</u>	<u>243</u>
Cash flows from investing activities:		
Investments purchased	(20)	-
Interest received on investments	<u>14</u>	<u>15</u>
Net cash (used in) provided by investing activities	<u>(6)</u>	<u>15</u>
Net increase in restricted cash and investments	58	160
Restricted cash and investments, beginning of the period	<u>3,381</u>	<u>3,350</u>
Restricted cash and investments, end of the period	<u>\$ 3,439</u>	<u>\$ 3,510</u>
Reconciliation of operating income to net cash used in operating activities:		
Income from operations	<u>\$ -</u>	<u>\$ -</u>
Changes in net assets and liabilities to reconcile operating income to net cash used in operations:		
Recoverable costs	(167)	(164)
Inventory - natural gas	-	(8)
Due from other funds	-	21
Accounts payable	<u>20</u>	<u>53</u>
Total adjustments	<u>(147)</u>	<u>(98)</u>
Net cash used in operating activities	<u>\$ (147)</u>	<u>\$ (98)</u>

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

# Department of Water Resources Electric Power Fund

## Notes to Financial Statements

For the three months ended September 30, 2004 and 2003

(in millions)

### 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.

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.

#### 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 September 30, 2004 and June 30, 2004, and the changes in its financial position and its cash flows, where applicable, for the three month periods ended September 30, 2004 and September 30, 2003 in conformity with accounting principles generally accepted in the United States of America.

### 2. Restricted Cash and Investments

As of September 30, 2004, \$32 million of the Fund's cash deposits of \$61 million was exposed to custodial credit risk as follows:

Institution	Amount
Prime Value Obligation Fund	
Institutional Shares	27
U.S. Bank	5
Total	<u>\$ 32</u>

# Department of Water Resources Electric Power Fund

## Notes to Financial Statements

For the three months ended September 30, 2004 and 2003

(in millions)

As of September 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	\$ 2,805
Guaranteed investment contracts	May 1, 2022	500
Forward purchase agreements	November 1, 2004	100
Natural gas futures and options	3 months average	42
Other	5 year average	1
Total		<u>\$ 3,448</u>

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

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

### 3. Long-Term Debt

The following activity occurred in the long-term debt accounts during the three months ended September 30, 2004:

	Revenue Bonds	Unamor- tized Premium	Total Revenue Bonds
Balance, June 30, 2004	\$ 11,084	\$ 330	\$ 11,414
Amortization of premium		(12)	(12)
Less current portion	(388)	(44)	(432)
Balance, September 30, 2004	<u>\$ 10,696</u>	<u>\$ 274</u>	<u>\$ 10,970</u>

# Department of Water Resources Electric Power Fund

## Notes to Financial Statements

For the three months ended September 30, 2004 and 2003

(in millions)

Total interest cost, including amortization of premium, for the three months ended September 30, 2004 and September 30, 2003 for all revenue bonds was \$110 million and \$105 million, respectively. The interest rates for the variable debt for the three months ended September 30, 2004 ranged from 0.87% to 1.80%.

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

Fiscal Year	Principal	Interest <sup>1</sup>	Total
2005	388	319	707
2006	409	408	817
2007	427	391	818
2008	449	371	820
2009	471	349	820
2010-2014	2,750	1,422	4,172
2015-2019	3,580	742	4,322
2020-2022	2,610	141	2,751
	<u>\$ 11,084</u>	<u>\$ 4,143</u>	<u>\$ 15,227</u>

<sup>1</sup> Variable portion of interest cost calculated using the September 30, 2004 Bond Market Association Municipal Swap Index (BMA).

#### 4. Interest Rate Swaps

The terms, fair values, and credit ratings of counterparties for the various swap agreements are summarized in the following table:

Outstanding Notional Amount at September 30, 2004	Fixed Rate Paid by Fund	Variable Rate Received by the Fund <sup>1</sup>	Fair Values at September 30, 2004	Swap Termination Date	Counterparty Credit Ratings (Moody's, Fitch, S&P)
\$ 94	2.914%	67% of LIBOR	\$ (4)	May 1, 2011	Aaa, AAA, AAA
234	3.024%	67% of LIBOR	(8)	May 1, 2012	Aaa, AAA, AAA
200	3.405%	BMA	(8)	May 1, 2013	Aa3, A+, A+
100	3.405%	BMA	(3)	May 1, 2013	Aa3, AA-, A+
30	3.405%	BMA	(1)	May 1, 2013	Aa3, AA-, A+
194	3.204%	67% of LIBOR	(5)	May 1, 2014	Aa1, AA-, AA-
174	3.280%	67% of LIBOR	(9)	May 1, 2015	Aaa, AAA, AAA
202	3.342%	67% of LIBOR	(6)	May 1, 2016	Aa2, AA, AA-
202	3.389%	67% of LIBOR	(6)	May 1, 2017	Aa3, AA-, A+
<u>\$ 1,430</u>			<u>\$ (50)</u>		

<sup>1</sup> One month U.S. Dollar London Interbank Offered Rate or Bond Market Association Municipal Swap Index

# Department of Water Resources Electric Power Fund

## Notes to Financial Statements

For the three months ended September 30, 2004 and 2003

(in millions)

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 September 30, 2004, the Fund was not exposed to credit risk because the swaps had negative fair values.

*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). As of September 30, 2004, the variable rate on DWR's hedged bonds ranged from 0.87% to 1.80%, while 67% of LIBOR received on the swap was equal to 1.233%.

*Termination Risk:* DWR's swap agreements do not contain any out-of-the-ordinary termination events that would expose it to significant termination risk.

*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 September 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:

Fiscal Year Ending June 30	Variable Rate Bonds		Interest Rate Swaps, Net	Total
	Principal	Interest		
2005	\$ -	\$ 18	\$ 20	\$ 38
2006	-	24	27	51
2007	-	24	27	51
2008	-	24	27	51
2009	-	24	27	51
2010-2014	852	103	122	1,077
2015-2017	578	20	25	623
	<u>\$ 1,430</u>	<u>\$ 237</u>	<u>\$ 275</u>	<u>\$ 1,942</u>

# Department of Water Resources Electric Power Fund

## Notes to Financial Statements

For the three months ended September 30, 2004 and 2003

(in millions)

### 5. 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.

#### 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 requirements.

# Department of Water Resources Electric Power Fund

## Notes to Financial Statements

For the three months ended September 30, 2004 and 2003

(in millions)

### Commitments

DWR has power purchase contracts that have remaining lives of up to ten years. Payments made under these contracts approximated \$1.4 billion for both the three months ended September 30, 2004 and September 30, 2003.

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

<b>For the Year Ending June 30,</b>	<b>Fixed Obligation</b>
2005	\$ 2,169
2006	2,783
2007	2,525
2008	2,379
2009	2,238
Thereafter	3,443
	<u>\$ 15,537</u>

In addition to the fixed costs there are variable costs under several of the contracts. Management projected as of September 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.

### 6. 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 April 2004, a settlement was signed with Dynegy Inc. which becomes effective October 25, 2004. This settlement will be recognized as revenue as of the effective date. Under the terms of the settlement's allocation agreement, DWR received approximately \$100 million in November 2004.