Department of Water Resources
Electric Power Fund
Financial Statements

March 31, 2006

Department of Water Resources Electric Power Fund
Index

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, 2005 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. The IOUs are responsible for the scheduling, dispatch, and certain other administrative functions for the contracts. However, DWR retains the legal and financial responsibility for the 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.

STATEMENT OF NET ASSETS

The Fund's assets and liabilities as of March 31, 2006 and June 30, 2005 are summarized as follows (in millions):

	March 31, 2006		June 30, 2005	
Long-term restricted cash and investments	$	1,501	$	1,482
Recoverable costs, net of current portion		7,372		7,356
Restricted cash and investments:				
Operating and priority contract accounts		791		1,387
Bond charge collection and bond charge payment accounts		909		570
Other investments		97		80
Recoverable costs, current portion		656		573
Interest receivable		38		26
Total assets	$	11,364	$	11,474
Net assets	$	-	$	-
Long-term debt, including current portion		10,906		10,982
Accounts payable		335		424
Accrued interest payable		123		68
Total capitalization and liabilities	$	11,364	$	11,474

Long-Term Restricted Cash and Investments

The $591 million and $555 million balances in the Operating Reserve Account at March 31, 2006 and June 30, 2005, respectively are determined in accordance with the bond indenture and represent twelve percent of projected annual operating expenses of the Fund for calendar years 2006 and 2005, respectively. There was a decrease of $17 million to $910 million in the Debt Service Reserve Account during the nine month period. The lower debt service reserve requirement results from reduced future annual debt service from the issuance of refunding bonds as described in the Long-Term Debt section below.

Recoverable Costs, Net of Current Portion

Long-term recoverable costs consist of costs that are recoverable through future billings. The $16 million increase during the nine month period ended March 31, 2006 is net of 1) operating expenses which exceed operating revenues by $413 million, and 2) bond charges plus interest income exceeding interest expense by $397 million.

Restricted Cash and Investments

The $791 million balance in the Operating and Priority Contract Accounts at March 31, 2006 is $41 million higher than forecast in DWR's 2006 Revenue Requirement determination. The Operating and

Priority Contract Accounts had a net decrease of $596 million in the nine months ended March 31, 2006 which is $80 million greater than forecast in the combined 2005 and 2006 Revenue Requirements. The decrease beyond the planned decrease is the result of higher than projected natural gas prices in fall 2005 used to generate energy, partially offset by the collection of $188 million in energy settlements that were not forecast in the 2005 and 2006 Revenue Requirement.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $339 million during the nine months ended March 31, 2006. The increase in the balances was expected in anticipation of the $436 million principal payment due in May 2006.

From the dates of issuance of the revenue bonds through March 31, 2006, 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.

Other investments increased by $17 million in the nine months ended March 31, 2006. At March 31, 2006, the account consists of money market obligations, U.S. Treasury bills, and government bonds valued at $32 million and financial futures and options valued at $65 million. The higher prices for natural gas in fall 2005 provided benefit to the account value through the first six months of the nine month period. As prices declined in the last three months prior to March 31, 2006, some of the prior gains were offset with losses on forward positions. At March 31, 2006, DWR has open positions with an unrealized marked-to-market value decrease of $82 million. During the three months ended March 31, 2006 DWR funded the account with $100 million to collateralize unrealized losses and enable future hedging transactions.

Recoverable Costs, Current Portion

The current portion of recoverable costs principally reflects billings to IOU customers that have not yet been collected. The current portion of recoverable costs at March 31, 2006, is higher than at June 30, 2005, primarily due to higher remittance rates implemented at the beginning of calendar year 2006.

Long-Term Debt

In December 2005, DWR issued an aggregate $2.594 billion in variable rate refunding revenue bonds to advance refund $2.352 billion of outstanding 2002 Series A fixed rate bonds.

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

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

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

Accounts Payable

Accounts payable at March 31, 2006 are $89 million lower than at June 30, 2005 and reflect one month's accrual for power and gas purchases. The principal reasons for the decrease are 1) slightly lower gas prices, 2) lower dispatchable contract costs due to decreased demand from moderate weather and higher than expected regional hydro resources, and (3) the expiration of two contracts on December 31, 2005.

Accrued Interest Payable

Accrued interest payable is $55 million higher at March 31, 2006 than at June 30, 2005. This increase is anticipated as the fixed rate bonds provide for semiannual interest payments on May 1st and November 1st, while the variable rate bonds provide for more frequent payments.

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Fund's activities for the three months and nine months ended March 31, 2006 and 2005 are summarized as follows (in millions):

	Three months ended March 31		Nine months ended March 31	
	2006	**2005**	**2006**	**2005**
Revenues:				
Power charges	$ 1,167	$ 946	$ 2,960	$ 3,446
Surplus sales	143	162	384	322
Bond charges	200	199	624	651
Interest income	33	22	95	68
Total revenues	1,543	1,329	4,063	4,487
Expenses:				
Power purchases	1,288	1,061	3,941	3,863
Energy settlements	(33)	(17)	(212)	(113)
Interest expense	97	109	322	325
Other expenses	11	15	28	42
Recovery (deferral) of recoverable costs	180	161	(16)	370
Total expenses	1,543	1,329	4,063	4,487
Net income	-	-	-	-
Net assets, beginning of the period	-	-	-	-
Net assets, end of period	$ -	$ -	$ -	$ -

Power Charges

Revenues from power charges increased by $221 million in the three months ended March 31, 2006 compared to the same period ending March 31, 2005, primarily due to higher remittance rates in place for the calendar year 2006 compared with rates in place for 2005. Revenues from power charges decreased by $486 million in the nine months ended March 31, 2006 compared to the same period ending March 31, 2005. The volume of power sold in the nine month period ended March 31, 2006 is 9% less than sold in the same period in the prior year, primarily because of the expiration of a major contract at December 31, 2004. Additionally, calendar year 2005 remittance rates, based on DWR's 2005 Revenue Requirement, are lower than the calendar year 2004 remittance rates. DWR was able to reduce remittance rates in calendar year 2005 to purposefully reduce the cash balance in the Operating Account and yet maintain balances in the Operating, Priority Contract, and Operating Accounts in excess of bond indenture requirements.

Surplus Sales

Revenues from surplus sales of energy increased by $62 million in the nine months ended March 31, 2006 compared to the same period in the prior year. Although the quantities of surplus energy sold are comparable during the two periods, the dollar value of sales of excess natural gas in the nine months ending March 31, 2006 reflects overall higher natural gas prices compared with the prior year.

Bond Charges

Bond charges earned through the nine months ended March 31, 2006, were $27 million less than the same period in the prior year. The reduction was the result of a lower bond charge rates in place for the nine month period ended March 31, 2006 compared to the rate in place for the same period in the prior year. The bond charges received have been adequate to meet all debt service requirements and maintain balances in the Bond Charge Collection, Bond Charge Payment, and Debt Service Reserve Accounts that are in excess of the bond indenture requirements.

Interest Income

There was a $27 million increase and an $11 million increase in interest income in the nine month and three month periods ended March 31, 2006, respectively, as compared to the same periods ending March 31, 2005. The increase in interest income is attributable to higher rates received on investments in the State of California Pooled Money Investment Account.

Power Purchases

The volume of power purchases in the nine months ended March 31, 2006 is approximately 9% lower than in the same period in the prior year, reflecting the expiration of a large contract at December 31, 2004. Power costs are 2% higher ($78 million) in the nine month period ended March 31, 2006 than in the same period ending March 31, 2005. This reflects the higher gas prices for the generation of energy in the nine months ended March 31, 2006 than in the same period in the prior year, offset by a $17 million increase in value of the financial hedging portfolio during the nine months ended March 31, 2006

Power costs are $227 million (21%) higher for the three month period ended March 31, 2006 than in the same period in 2005. This is due to natural gas prices being higher for the three month period than they were a year ago. In addition, DWR recognized a decrease in value of its financial hedging account of $76 million for the three month period ended March 31, 2006. This is primarily due to the effects of declining forward natural gas prices on existing hedge positions, as DWR entered some of its hedge transactions when prices were higher during the last six months of calendar year 2005.

Energy Settlements

Energy settlements, including those related to 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.

Three energy settlements totaling $212 million were recognized in the nine month period ended March 31, 2006. First, as part of the energy settlement with Mirant Corporation in 2005, DWR received unsecured claims totaling $90 million plus accrued interest in the Mirant Corporation bankruptcy case. In December 2005, DWR sold its claims and received $96 million. Second, the energy settlement with Enron Corp. became effective and DWR recognized $50 million in energy settlements through March 31, 2006. Other amounts owed from the Enron Corp. settlement are subject to bankruptcy court distributions and will be recognized as an energy settlement at such time as there is a distribution of monies. Finally, an energy settlement of $66 million with Reliant Energy became effective in December 2005 and was received in March 2006.

Interest Expense

There was a $3 million decrease and a $12 million decrease in the interest expense in the nine month and three month periods ended March 31, 2006, respectively, as compared to the same periods ending March 31, 2005. The lower interest expense in the three months ended March 31, 2006 is attributable to the impact of DWR's December 2005 advance bond refunding described in the Long-Term Debt section of Management's Discussion and Analysis.

Other Expenses

Administrative expenses decreased $14 million in the nine months ended March 31, 2006 compared to the same period in the prior year due to a reduction in statewide pro-rata cost allocation to the Fund and decreased costs incurred for contract renegotiation and litigation activities.

Recovery (Deferral) of Recoverable Costs

The individual components of the recovery (deferral) of recoverable costs for the three and nine months ended March 31, 2006 and 2005 are summarized as follows (in millions):

	Three months ended March 31		Nine months ended March 31	
	2006	2005	2006	2005
Operations	$ 44	$ 49	$ (413)	$ (24)
Debt Service and related costs	136	112	397	394
	$ 180	$ 161	$ (16)	$ 370

Operations
The $413 million deferral in the nine months ended March 31, 2006 recognizes both the increases in natural gas costs, and DWR's ability to reduce power charges in calendar 2005 through the revenue requirement process 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 nine month periods ended March 31, 2006 and 2005, and are comprised solely of the difference between bond charges plus interest income less interest expense.

FUTURE OPERATIONS

In August 2005, the Governor introduced legislation that would establish a Department of Energy through the consolidation of the functions of several departments, commissions and offices that currently implement state energy programs. If the legislation were to be enacted, all of the powers, duties, responsibilities, rights, obligations, liabilities and jurisdiction of DWR under Division 27 of the California Water Code would be assumed by the Department of Energy.

DWR or its successor 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 California Public Utilities Commission (CPUC) for implementation. Under the terms of the rate agreement between the CPUC and DWR, the CPUC is required to set rates for the customers of the IOUs and "direct access" Electric Service Providers such that the Fund will always have monies to pay the principal of and interest on the bonds and all other bond related costs when due.

DWR has the authority to administer all power supply contracts entered into before December 31, 2002, for the life of the contracts. Over 95% of the volume of power under contract expires by December 31, 2011 and the last of the contracts is projected to expire in 2017. 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 or its successor. However, there are a number of issues to be addressed, including IOU acceptance of the assignment and counterparty approval, before the contracts can be assigned.

Department of Water Resources Electric Power Fund
Statements of Net Assets
March 31, 2006 and June 30, 2005 (in millions)

	March 31, 2006	June 30, 2005
Assets		
Long-term assets:		
Restricted cash and investments:		
Operating Reserve Account	$ 591	$ 555
Debt Service Reserve Account	910	927
Recoverable costs, net of current portion	7,372	7,356
Total long-term assets	8,873	8,838
Current assets:		
Restricted cash and investments:		
Operating and Priority Contract Accounts	791	1,387
Bond Charge Collection and Bond Charge Payment Accounts	909	570
Other investments	97	80
Recoverable costs, current portion	656	573
Interest receivable	38	26
Total current assets	2,491	2,636
Total assets	$ 11,364	$ 11,474
Capitalization and Liabilities		
Capitalization:		
Net assets	$ -	$ -
Long-term debt:		
Revenue bonds	10,447	10,529
Total capitalization	10,447	10,529
Current liabilities:		
Current portion of long-term debt	459	453
Accounts payable	335	424
Accrued interest payable	123	68
Total current liabilities	917	945
Commitments and Contingencies (Note 5)		
Total capitalization and liabilities	$ 11,364	$ 11,474

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 and nine months ended March 31, 2006 and 2005 (in millions)

	Three months ended March 31		Nine months ended March 31	
	2006	**2005**	**2006**	**2005**
Operating revenues:				
Power charges	$ 1,167	$ 946	$ 2,960	$ 3,446
Surplus sales	143	162	384	322
Total operating revenues	1,310	1,108	3,344	3,768
Operating expenses:				
Power purchases	1,288	1,061	3,941	3,863
Energy settlements	(33)	(17)	(212)	(113)
Administrative expenses	11	15	28	42
Recovery (deferral) of recoverable operating costs	44	49	(413)	(24)
Total operating expenses	1,310	1,108	3,344	3,768
Income from operations	-	-	-	-
Bond charges	200	199	624	651
Interest income	33	22	95	68
Interest expense	(97)	(109)	(322)	(325)
Recovery of recoverable debt service and related costs	(136)	(112)	(397)	(394)
Net income	-	-	-	-
Net assets, beginning of the period	-	-	-	-
Net assets, end of the period	$ -	$ -	$ -	$ -

The accompanying notes are an integral part of these financial statements

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the nine months ended March 31, 2006 and 2005 (in millions)

	2006	2005
Cash flows from operating income:		
Receipts:		
Power charges	$ 2,874	$ 3,539
Surplus sales	411	335
Energy settlements	188	113
Payments for power purchases and other costs	(3,979)	(4,054)
Net cash used in operating activities	(506)	(67)
Cash flows from non-capital financing activities:		
Receipts from customers for bond charges	624	652
Interest payments	(280)	(256)
Proceeds from issuance of revenue bonds	2,594	-
Cost of issuance net of underwriters discount	(25)	-
Defeasance of revenue bonds	(2,628)	-
Net cash provided by non-capital financing activities	285	396
Cash flows from investing activities:		
Investments purchased	(100)	(50)
Interest received on investments	83	52
Net cash (used in) provided by investing activities	(17)	2
Net (decrease) increase in restricted cash and investments	(238)	331
Restricted cash and investments, beginning of the period	3,439	3,381
Restricted cash and investments, end of the period	$ 3,201	$ 3,712
Reconciliation of operating income to net cash used in operating activities:		
Income from operations	$ -	$ -
Changes in net assets and liabilities to reconcile operating income to net cash used in operations:		
Recoverable costs	(595)	54
Accounts payable	89	(121)
Total adjustments	(506)	(67)
Net cash used in operating activities	$ (506)	$ (67)

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

March 31, 2006 (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 contracts entered into prior to January 1, 2003 and delivers the power to the customers through the transmission and distribution systems of the IOUs. 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 in conformity with accounting principles generally accepted in the United States of America.

2. Restricted Cash and Investments

As of March 31, 2006, $38 million of the Fund's cash deposits of $61 million was exposed to custodial credit risk as follows:

Institution	Amount	Custodial Credit Risk
Prime Value Obligations Fund Institutional Shares	$ 16	Insured
U.S. Bank	22	Uninsured and uncollateralized
	$ 38	

As of March 31, 2006, the Fund had the following investments:

March 31, 2006 (in millions)

Investment	Maturity	Fair Value
State of California Pooled Money Investment Account - State Money Investment Fund	5.5 months average	$ 2,556
Guaranteed investment contracts	May 1, 2022	500
Forward purchase agreement	May 1, 2006	100
Natural gas futures and options	3 months average	65
Other	5 year average	16
		$ 3,237

The Fund's investments in the guaranteed investment contracts (GIC) and forward purchase agreement (FPA) are rated as follows by Standard & Poor's (S&P) and Moody's, respectively, at March 31, 2006:

Investment	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	AA+	Aa1
	$ 500		
FPA Provider			
Merrill Lynch: FHLMC Discounted Notes	$ 100	AAA	Aaa

3. Long-Term Debt

The following activity occurred in the long-term debt accounts during the nine months ended March 31, 2006:

	Revenue Bonds	Unamor-tized Premium	Deferred Loss on Defeasance	Total Revenue Bonds
Balance, June 30, 2005	$ 10,696	$ 286	$ -	$ 10,982
Refunding				
Issuance of debt	2,594			2,594
Defeasance of debt	(2,353)	(72)	(218)	(2,643)
Amortization		(31)	4	(27)
Less current portion	(436)	(37)	14	(459)
Balance, March 31, 2006	$ 10,501	$ 146	$ (200)	$ 10,447

March 31, 2006 (in millions)

In December 2005, the Fund issued an aggregate $2,594 in Power Supply Revenue Bonds. The bonds issued were variable rate bonds and were comprised of the $759 Series F-Daily Rate Reset and $1,835 Series G-Weekly Rate Reset bonds. These bonds were used to refund $2,352 of outstanding fixed rate bonds, and to pay cost of issuance and certain costs of credit and liquidity enhancement.

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

The advance refunding resulted in an accounting loss of approximately $218, which has been deferred over the life of the refunded debt. However, the Fund effectively reduced its aggregate debt service payments by approximately $278 through 2022 and obtained a net economic gain (difference between the present values of the old and new debt service payments) of $145. The actual economic gain will be dependent on basis risk associated with interest rate swaps that became effective and are further described in Note 4 to the financial statements.

The revenue bonds, all of which except series E are tax-exempt, consist of the following at March 31, 2006:

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amounts Outstanding
A	3.0-6.0%	2022	2012	$ 3,843
B	Variable	2020	Callable	1,000
C	Variable	2022	Callable	2,750
D	Variable	2022	Callable	500
E	4.3%	2006	Not callable	250
F	Variable	2022	Callable	759
G	Variable	2018	Callable	1,835
				10,937
Plus unamortized bond premium				183
Less unamortized loss on bond redemption				(214)
Less current maturities				(459)
				$ 10,447

The interest rates for the variable debt for the nine months ended March 31, 2006, ranged from 1.50% to 3.75%

March 31, 2006 (in millions)

Future payment requirements on the revenue bonds are as follows at March 31, 2006:

Fiscal Year	Principal	Interest [1]	Total
2006	$ 436	$ 106	$ 542
2007	448	408	855
2008	470	388	858
2009	493	366	859
2010	518	344	862
2011-2015	3,024	1,325	4,350
2016-2020	3,792	808	4,599
2021-2022	1,757	133	1,890
	$ 10,937	$ 3,877	$ 14,814

[1] Variable portion of interest cost calculated using the March 31, 2006 Bond Market Association Municipal Swap Index.

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	Fixed Rate Paid by Fund	Variable Rate [1] Received by Fund	Fair Value	Termination Date	Counterparty Credit Rating S&P	Moody's	Fitch
$ 94	2.914%	67% of LIBOR	$ 2	May 1, 2011	AAA	Aaa	AAA
234	3.024%	67% of LIBOR	4	May 1, 2012	AAA	Aaa	AAA
200	3.405%	BMA	-	May 1, 2013	A+	Aa3	A+
100	3.405%	BMA	-	May 1, 2013	A+	Aa3	AA-
30	3.405%	BMA	-	May 1, 2013	A+	Aa3	AA-
194	3.204%	67% of LIBOR	3	May 1, 2014	AA-	Aa1	AA-
355	3.184%	66.5% of LIBOR	6	May 1, 2015	AA-	Aa3	AA-
174	3.280%	67% of LIBOR	2	May 1, 2015	AAA	Aaa	AAA
202	3.342%	67% of LIBOR	2	May 1, 2016	AA	Aa2	AA
485	3.228%	66.5% of LIBOR	12	May 1, 2016	AA	Aa2	AA
202	3.389%	67% of LIBOR	2	May 1, 2017	A+	Aa3	AA-
480	3.282%	66.5% of LIBOR	11	May 1, 2017	AA-	A2	AA-
514	3.331%	66.5% of LIBOR	13	May 1, 2018	AA-	A3	AA-
306	3.256%	64% of LIBOR	8	May 1, 2020	AA-	A3	AA-
453	3.325%	64% of LIBOR	14	May 1, 2022	AA-	Aa2	AA
$ 4,024			$ 79				

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

The BMA and 67% of LIBOR swaps were effective in February 2003. All other swaps were effective December 1, 2005.

March 31, 2006 (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 derived from a combination of DWR valuations and those provided by the counterparties. Valuations use the par value, or marked-to-market, method.

Credit Risk: As of March 31, 2006, the Fund was exposed to aggregate counterparty credit risk exposure of $79 because the swaps had positive fair values as calculated on that date. All swap counterparties have investment grade credit ratings from three major credit ratings agencies shown in the table.

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 March 31, 2006, the variable rate on DWR's hedged bonds ranged from 3.00% to 3.20%, while the variable rates received on the swaps were based on 64% to 67% of LIBOR and ranged from 3.089% to 3.233%.

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 March 31, 2006, 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:

	Variable Rate Bonds		Interest Rate	
Fiscal Year	**Principal**	**Interest**	**Swaps, Net**	**Total**
2006	$ -	$ 32	$ 1	$ 33
2007	-	128	3	131
2008	-	128	3	131
2009	-	128	3	131
2010	-	128	3	131
2011-2015	1,381	577	17	1,975
2016-2020	2,190	233	11	2,434
2021-2022	453	28	2	483
	$ 4,024	$ 1,382	$ 43	$ 5,449

5. Commitments and Contingencies

Litigation

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

In July, 2001, the Federal Energy Regulatory Commission (FERC) initiated a proceeding to calculate refunds for inflated prices in the California Independent System Operator (CAISO) and California Power Exchange Corporation markets during 2000 and 2001. DWR purchased $2.9 billion in energy to meet the CAISO's emergency needs during 2001. DWR is treated in the FERC refund proceeding as a seller of that energy to CAISO, and in May 2004, FERC issued an order requiring DWR to pay refunds on the $2.9 billion in "sales" to the CAISO. The refund amount totals approximately $2.2 billion on a gross basis, of which DWR could actually owe up to approximately $150 million on a net basis, because DWR would be the primary recipient of the refunds FERC required DWR to pay. However, FERC also later ruled that, like all sellers, to the extent DWR could demonstrate that payment of the refunds would result in DWR's costs exceeding its revenues, DWR could request FERC to reduce the refunds that would be owed. DWR sold all energy to the CAISO at its cost of acquisition. In September 2005, DWR made a cost recovery filing to request such a reduction in its refund obligation. Should the Fund be required to pay any refunds as a result of this FERC proceeding, the refunds would be recoverable from ratepayers through future revenue requirements.

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 consolidated set of cases, the issue is whether and to what extent compensation is due from the State of California as a result of the State's commandeering of certain block forward contracts in early 2001. Certain market participants claim that they are entitled to damages in excess of $1 billion, their estimation of the fair value of the block forward contracts at the time of commandeering. DWR paid approximately $352 million for energy provided under the contracts, which expired in December 2001. Given the early state of the proceeding, it is not possible to predict or determine the outcome of this matter or to provide an estimate of any losses, if any, that may arise. However, management believes that the costs associated with this action will not have a material adverse effect on the Fund's financial position or liquidity. Should the Fund be determined to be the source of moneys to pay any damages resulting from this litigation, those damages would be recoverable from ratepayers through future DWR revenue requirements.

Management is unsure of the timing of resolution of the existing lawsuits and regulatory proceedings. Because of the ongoing nature of the legal and regulatory proceedings, the ultimate outcome of these matters cannot be presently determined.

Commitments

DWR has power purchase contracts that have remaining lives of up to ten years. Payments made under these contracts approximated $3.9 billion and $3.9 billion for the nine months ended March 31, 2006 and 2005, respectively.

March 31, 2006 (in millions)

The remaining amounts of fixed obligations under the contracts as of March 31, 2006, are as follows:

Fiscal Year	Fixed Obligation
2006	$ 578
2007	2,525
2008	2,379
2009	2,238
2010	1,805
Thereafter	1,638
	$ 11,162

In addition to the fixed costs there are variable costs under several of the contracts. Management projected as of March 31, 2006 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $21 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.

Three energy settlements totaling $212 were recognized in the nine month period ended March 31, 2006. First, as part of the energy settlement with Mirant Corporation in 2005, DWR received unsecured claims totaling $90 plus accrued interest in the Mirant Corporation bankruptcy case. In December 2005, DWR sold its claims and received $96. Second, the energy settlement with Enron Corp. became effective and DWR has recognized $50 in energy settlements through March 31, 2006. Other amounts owed from the Enron Corp. settlement are subject to bankruptcy court distributions and will be recognized as energy settlements at such time as there is a distribution of monies. Finally, an energy settlement of $66 with Reliant Energy became effective in December 2005 and was received in March 2006.