

State of California

Public Utilities Commission
San Francisco

MEMORANDUM

Date : October 8, 2010

To : The Commission
(Meeting of October 14, 2010)

From : Peter Allen and Joel Perlstein 
Public Utilities Counsel IV

Subject: Approval of the Clarification of the September 2010 Addendum to Summary of Material Terms of Financing Documents

Recommendation: Approve the attached Clarification of the September 2010 Addendum to Summary of Material Terms on the 10/14 consent agenda.

Background: On the Commission's 9/23/10 agenda, the Commission approved the September 2010 Addendum to Summary of Material Terms of Division of Water Resources (DWR) Financing Documents to provide for refunding of a portion of DWR's Power Supply Revenue Bonds (see Attachment). DWR is now clarifying that any projected present value savings determination is to be based upon an aggregate test relating to all of the bonds being refunded. More detail is provided in the attached memorandum from DWR to Frank Lindh, dated October 6, 2010.

Discussion: Jake Wise of Energy Division has reviewed this clarification, along with the financial projections underlying DWR's proposed bond refunding. With the clarification, it appears likely that DWR's proposal will reduce costs to ratepayers and avoid significant interest rate risk. Accordingly we recommend that the Commission approve the attached Clarification of the September 2010 Addendum to Summary of Material Terms on the consent agenda on 10/14/10, so that DWR can proceed to issue the necessary bond sale prospectus and take advantage of the current low interest rate environment. More detail is provided in the attached memo from DWR to Frank Lindh. Also attached is the information presented to the Commission for the 9/23/10 agenda.

Memorandum

Date: October 6, 2010

To: Frank Lindh
General Counsel
California Public Utilities Commission
505 Van Ness Avenue, Room 5138
San Francisco, California 94102-3298

From: Department of Water Resources

Subject: Clarification of September 2010 Addendum to the Summary of Material Terms of Financing Documents Relating to the Refunding of Selected Department of Water Resources (DWR) Power Supply Fixed Rate Bonds for Savings and Restructuring of Selected Variable Rate Demand Bonds to Address Expiring Letters and Lines of Credit

By memorandum dated September 20, 2010 (incorporated herein by reference), DWR advised the California Public Utilities Commission (Commission) that, as a follow up to its Phase I May 2010 refunding transaction, DWR has determined that it is financially prudent at this time to issue additional fixed rate bonds as part of a Phase II transaction, in order to take advantage of historic low interest rates to provide cost savings to ratepayers and further reduce the counterparty risk within DWR's bond portfolio. The September 20 memorandum also transmitted to the Commission DWR's September 2010 Addendum to the Summary of Material Terms of Financing Documents.

Among other matters, in the September 2010 Addendum, DWR stated that, prior to the issuance of Phase II 2010 Refunding Bonds for the purpose of refunding variable rate bonds, DWR will furnish to Commission DWR's determination either (a) that there are present value savings projected to result from the issuance of such Phase II 2010 Refunding Bonds (taking into account all projected Bond-Related Costs related to the Phase II 2010 Refunding Bonds and the variable rate bonds being refunded), or (b) that it is necessary or desirable to refund unhedged variable rate Bonds because liquidity facilities are not available in sufficient amounts at reasonable fees and terms.

By delivery of the amended September 2010 Addendum attached hereto, DWR is clarifying that the present value savings determination described in clause (a) of the preceding paragraph is to be an aggregate test relating to all of the bonds being refunded pursuant to that determination.

Once again, DWR appreciates your timely action with respect to Commission's participation in the process for the sale and issuance of DWR's Power Supply Revenue Bonds.

Please contact Russell Mills, Chief, Financial Management Office at (916) 574-2756 or me at (916) 574-2733 if there are any questions.



John Pacheco
Acting Deputy Director
California Energy Resources Scheduling

Attachment: Addendum to the Summary of Material Terms of Financing Documents

cc: Honorable Michael R. Peevey, President
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, California 94102

Honorable John A. Bohn, Commissioner
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, California 94102

Honorable Dian M. Grueneich, Commissioner
California Public Utilities Commission
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Honorable Nancy E. Ryan, Commissioner
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Honorable Timothy Alan Simon, Commissioner
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Mr. Paul Clanon
Executive Director
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505 Van Ness Avenue, Room 5222
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Mr. Mark W. Cowin
Director
Department of Water Resources
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Sacramento, California 95814

Ms. Cathy Crothers
Acting Chief Counsel
Department of Water Resources
1416 9th Street
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Mr. Russell Mills, Chief
Financial Management Office, CERS
2033 Howe Avenue, Suite 220
Sacramento, California 95825

THIS SEPTEMBER 2010 ADDENDUM TO SUMMARY OF MATERIAL TERMS OF FINANCING DOCUMENTS, dated as of September 20, 2010 and amended as of October 6, 2010 (the "September 2010 Addendum"), is a supplement to the Summary of Material Terms of Financing Documents ("Summary of Material Terms") which was attached to a memorandum dated February 21, 2002 from the California Department of Water Resources ("DWR") to the California Public Utilities Commission ("CPUC") as Attachment A, as the same was supplemented and amended by the following: (a) an Amended and Restated Addendum to Summary of Material Terms dated as of August 8, 2002 (the "2002 Addendum"), (b) an Addendum to Summary of Material Terms of Financing Documents dated as of September 20, 2005 (the "2005 Addendum"), (c) an Addendum to Summary of Material Terms of Financing Documents dated as of February 27, 2008 (the "February 2008 Addendum"), (d) an Addendum to Summary of Material Terms of Financing Documents dated as of March 12, 2008 (the "March 2008 Addendum"); (e) an Addendum to Summary of Material Terms of Financing Documents dated as of December 17, 2008 (the "December 2008 Addendum"), and (f) an April 2010 Addendum to Summary of Material Terms of Financing Documents (the "April 2010 Addendum", and collectively with the 2002 Addendum, the 2005 Addendum, the February 2008 Addendum, the March 2008 Addendum and the December 2008 Addendum, the "Previous Addenda"). All undefined terms in this September 2010 Addendum shall be defined by reference to the Rate Agreement dated as of March 8, 2002 (the "2002 Rate Agreement") between DWR and CPUC and the Trust Indenture dated as of October 1, 2002 among DWR, the Treasurer of the State of California, as Trustee, and U.S. Bank National Association, as Co-Trustee, as amended (the "Indenture").

DWR has determined (1) that current market conditions and expiring Enhancement Facilities make it necessary and appropriate to reduce DWR's exposure to market uncertainties relating to the credit ratings of the providers of Enhancement Facilities and relating to the cost and limited availability of Enhancement Facilities, (2) that it can achieve those objectives by refunding variable rate demand Bonds previously issued by DWR under the Indenture with fixed rate refunding Bonds, (3) that current market conditions also make it likely that debt service savings can be achieved by the issuance of fixed rate refunding Bonds for the purpose of refunding a portion of its outstanding fixed rate Bonds, and (4) that in the case of each issuance of refunding Bonds described in clauses (2) and (3) of this paragraph it will be necessary or appropriate to enter into related Financing Documents and Enhancement Facilities, if any.

The Summary of Material Terms and the Previous Addenda specified certain matters which were reflected in the terms of the Financing Documents and addressed matters relating to the issuance or proposed issuance of Bonds in 2002, 2005, 2008 and 2010. This September 2010 Addendum addresses matters relating to the proposed issuance by DWR of the above-described refunding Bonds (the "Phase II 2010 Refunding Bonds"), including specifying that the Phase II 2010 Refunding Bonds are not subject to the maximum aggregate principal amount and proceeds limitations reflected in the Summary of Material Terms and the Previous Addenda and are instead subject to the limitations reflected herein and in the 2002 Rate Agreement. Except as provided herein, the Summary of Material Terms, as modified by the 2002 Addendum, shall apply, treating the Phase II 2010 Refunding Bonds as "Bonds" thereunder.

1. Maximum Amount of Phase II 2010 Refunding Bonds Authorized.

DWR will issue no more Phase II 2010 Refunding Bonds than it determines are necessary to provide for the defeasance and/or redemption of the Bonds being refunded and to pay costs incurred in connection with the issuance of the Phase II 2010 Refunding Bonds, the execution and delivery of the related Financing Documents (including Qualified Swap terminations, if any) and Enhancement Facilities, if any, and the defeasance and/or redemption of the Bonds being refunded. The principal amount of Phase II 2010 Refunding Bonds will also be limited as described in paragraph 3 below. All Phase II 2010 Refunding Bonds will be fixed rate and will be issued prior to December 31, 2010.

2. Use of Proceeds.

DWR will apply the proceeds of Phase II 2010 Refunding Bonds solely to fund an escrow providing for the defeasance and/or redemption of the Bonds being refunded and to the payment of costs incurred in connection with the issuance of the Phase II 2010 Refunding Bonds, the execution and delivery of the related Financing Documents (including Qualified Swap terminations, if any) and Enhancement Facilities, if any, and the defeasance and/or redemption of the Bonds being refunded. The Bonds to be refunded pursuant to this September 2010 Addendum will be determined by DWR, subject to the limitations of this September 2010 Addendum.

3. DWR Determinations as to Refundings.

Prior to the issuance of Phase II 2010 Refunding Bonds for the purpose of refunding fixed rate Bonds, DWR will furnish to the Commission DWR's determination that there are present value savings projected to result from the issuance of the Phase II 2010

Refunding Bonds for such purpose and the projected amount of such savings, which savings in the aggregate will not be less than 3% of the aggregate principal amount of the Bonds being refunded.

Prior to the issuance of Phase II 2010 Refunding Bonds for the purpose of refunding variable rate bonds, DWR will furnish to the Commission DWR's determination either (a) that there are, in the aggregate, present value savings projected to result from the issuance of such Phase II 2010 Refunding Bonds (taking into account all projected Bond-Related Costs related to the Phase II 2010 Refunding Bonds and the variable rate bonds being refunded), or (b) that it is necessary or desirable to refund unhedged variable rate Bonds because Enhancement Facilities are not available in sufficient amounts at reasonable fees and terms.

Each such determination will include a summary of the principal assumptions used in making such determination. The Department will, in the course of preparing to issue the Phase II 2010 Refunding Bonds and make such determination, provide to the Commission such information as the Commission may request concerning matters relating to such determination and the assumptions therein.

4. Rate Agreement Applicable to Phase II 2010 Refunding Bonds.

The Phase II 2010 Refunding Bonds shall be entitled to the benefits of the Rate Agreement in accordance with the terms thereof.

ATTACHMENT

MEMORANDUM

Date : September 21, 2010

To : The Commission
(Meeting of September 23, 2010)

From : Peter Allen and Joel Perlstein 
Public Utilities Counsel IV

Subject: Approval of the September 2010 Addendum to Summary of Material Terms of Division of Water Resources (DWR) Financing Documents (as sent to the CPUC General Counsel by DWR on September 20th), to provide for refunding of a portion of DWR's Power Supply Revenue Bonds

RECOMMENDATION:

Approve the attached Addendum to Summary of Material Terms on 9/23/10 consent agenda.

BACKGROUND:

In response to the California energy crisis, DWR issued Power Supply Revenue Bonds to pay for procurement of electricity for California's major investor-owned utilities. DWR is seeking to refund a portion of those bonds to reduce costs to ratepayers, and to address the pending expiration of credit facilities on certain variable rate bonds. More detail is provided in the attached memo from DWR to Frank Lindh.

DISCUSSION:

Jake Wise of Energy Division has reviewed the financial projections underlying DWR's proposed bond refunding. DWR's proposal appears likely to reduce costs to ratepayers and avoids significant interest rate risk. Accordingly we recommend that the Commission approve the attached Addendum to Summary of Material Terms on the consent agenda on 9/23/10, so that DWR can proceed to issue the necessary bond sale prospectus and take advantage the current low interest rate environment. More detail is provided in the attached memo from DWR to Frank Lindh.

Memorandum

Date: September 20, 2010

To: Frank Lindh
General Counsel
California Public Utilities Commission
505 Van Ness Avenue, Room 5138
San Francisco, California 94102-3298

From: Department of Water Resources

Subject: Refunding of Selected Department of Water Resources (DWR) Power Supply Fixed Rate Bonds for Savings and Restructuring of Selected Variable Rate Demand Bonds to Address Expiring Letters and Lines of Credit

As a follow up to its Phase I May 2010 refunding transaction, DWR has determined that it is financially prudent at this time to issue additional fixed rate bonds as part of a Phase II transaction, in order to take advantage of historic low interest rates to provide cost savings to ratepayers and further reduce the counterparty risk within DWR's bond portfolio.

The low interest rate environment has presented DWR the opportunity to refund a portion of its 2002 Series A fixed rate bonds by issuing lower cost fixed rate bonds at current rates. DWR is targeting only those 2002 Series A bonds that will provide for aggregate savings of at least 3% of the par amount refunded. At current market rates, DWR has identified \$972 million of outstanding fixed rate bonds that can be refunded to obtain an estimated \$39 million in net present value savings for ratepayers.

In addition, after the Phase I refunding transaction in May, DWR has \$2 billion of variable rate bonds outstanding that have credit support through letters of credit and standby bond purchase facilities (collectively, "liquidity facilities"); of which \$1.34 billion expire by December 1, 2010 and an additional \$218 million expire in April 2011. After formalizing commitments from financial institutions through an RFP for new liquidity facility capacity in July, DWR projects that it will be more economically beneficial for ratepayers to refund a significant portion of the variable rate bonds with fixed rate bonds than to accept the replacement liquidity facility support at the fee levels offered by the banks. Therefore, DWR proposes to refund an estimated \$1.05 billion of its variable rate bonds and terminate all associated remaining interest rate swaps.

DWR has determined (1) that current market conditions and expiring liquidity facilities make it necessary and appropriate to reduce DWR's exposure to market uncertainties relating to the credit ratings of the providers of liquidity facilities and relating to the cost and limited availability of liquidity facilities, (2) that it can achieve those objectives by refunding variable rate demand Bonds previously issued by DWR under the Indenture with fixed rate refunding Bonds, (3) that current market conditions also make it likely that debt service savings can be achieved by the issuance of fixed rate refunding Bonds for the purpose of refunding a portion of its outstanding fixed rate Bonds, and (4) that in the case of each issuance of refunding Bonds described in clauses (2) and (3) of this

paragraph it will be necessary or appropriate to enter into related financing documents and credit enhancement facilities, if any.

Prior to the issuance of Phase II 2010 Refunding Bonds for the purpose of refunding fixed rate Bonds, DWR will furnish to the Commission DWR's determination that there are present value savings projected to result from the issuance of the Phase II 2010 Refunding Bonds for such purpose and the projected amount of such savings, in the aggregate, will not be less than 3% of the aggregate principal amount of the Bonds being refunded.

Prior to the issuance of Phase II 2010 Refunding Bonds for the purpose of refunding variable rate bonds, DWR will furnish to the Commission DWR's determination either (a) that there are present value savings projected to result from the issuance of such Phase II 2010 Refunding Bonds (taking into account all projected Bond-Related Costs related to the Phase II 2010 Refunding Bonds and the variable rate bonds being refunded), or (b) that it is necessary or desirable to refund unhedged variable rate Bonds because liquidity facilities are not available in sufficient amounts at reasonable fees and terms.

DWR plans to implement the transaction prior to the December 1, 2010 expiration date of the existing liquidity facilities. DWR's financial advisory firm, Montague DeRose, and the State Treasurer's Office will participate in the transaction.

Since the Summary of Material Terms of Financing Documents (the "Summary of Material Terms") and its existing addenda do not expressly provide for these refunding bonds, as with prior refundings, we are furnishing to the CPUC the attached Addendum to the Summary of Material Terms relating to the refundings described herein. The Addendum specifies that the proposed refunding bonds are not subject to the maximum aggregate principal amount and proceeds limitations reflected in the Summary of Material Terms and previous Addenda, but are instead subject to the limitations reflected in the new Addendum and the Rate Agreement.

The CPUC will need to provide various certifications and legal opinions for any bond sale.

The certificates and opinions that were provided in DWR's 2010 Phase I refunding are listed below:

- Certificate of the CPUC regarding Rate Agreement
- Certificate of the CPUC pursuant to Section 202.2(f) of Trust Indenture
- Certificate of the CPUC pursuant to Section 10(g)(xxiv) of purchase contract
- Opinion of the CPUC General Counsel
- Certificate of CPUC pursuant to Section 4.2(q) of the Master Credit, Liquidity and Participation Agreement

In addition, the CPUC's outside legal counsel provided a separate opinion on bankruptcy issues.

Frank Lindh
September 20, 2010
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DWR appreciates your timely review and delivery of the required documents to assist with this opportunity to provide savings and reduce risk exposure to the ratepayer with regard to the Power Revenue Bond portfolio. DWR requests that these proposals be reviewed and considered for approval at the CPUC September 23, 2010 Business Meeting.

Please contact Russell Mills, Chief, Financial Management Office at (916) 574-2756 or me at (916) 574-2733 if there are any questions.



John Pacheco
Acting Deputy Director
California Energy Resources Scheduling

Attachment: Addendum to the Summary of Material Terms of Financing Documents

cc: (See attached list.)

Frank Lindh
September 20, 2010
Page 4

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**THIS SEPTEMBER 2010 ADDENDUM TO SUMMARY OF
MATERIAL TERMS OF FINANCING DOCUMENTS, dated as of September 20, 2010 (the
"September 2010 Addendum"), is a supplement to the Summary of Material Terms of Financing
Documents ("Summary of Material Terms") which was attached to a memorandum dated
February 21, 2002 from the California Department of Water Resources ("DWR") to the
California Public Utilities Commission ("CPUC") as Attachment A, as the same was
supplemented and amended by the following: (a) an Amended and Restated Addendum to
Summary of Material Terms dated as of August 8, 2002 (the "2002 Addendum"), (b) an
Addendum to Summary of Material Terms of Financing Documents dated as of September 20,
2005 (the "2005 Addendum"), (c) an Addendum to Summary of Material Terms of Financing
Documents dated as of February 27, 2008 (the "February 2008 Addendum"), (d) an Addendum
to Summary of Material Terms of Financing Documents dated as of March 12, 2008 (the "March
2008 Addendum"), (e) an Addendum to Summary of Material Terms of Financing Documents
dated as of December 17, 2008 (the "December 2008 Addendum"), and (f) an April 2010
Addendum to Summary of Material Terms of Financing Documents (the "April 2010
Addendum", and collectively with the 2002 Addendum, the 2005 Addendum, the February 2008
Addendum, the March 2008 Addendum and the December 2008 Addendum, the "Previous
Addenda"). All undefined terms in this September 2010 Addendum shall be defined by
reference to the Rate Agreement dated as of March 8, 2002 (the "2002 Rate Agreement")
between DWR and CPUC and the Trust Indenture dated as of October 1, 2002 among DWR, the
Treasurer of the State of California, as Trustee, and U.S. Bank National Association, as Co-
Trustee, as amended (the "Indenture").**

DWR has determined (1) that current market conditions and expiring Enhancement Facilities make it necessary and appropriate to reduce DWR's exposure to market uncertainties relating to the credit ratings of the providers of Enhancement Facilities and relating to the cost and limited availability of Enhancement Facilities, (2) that it can achieve those objectives by refunding variable rate demand Bonds previously issued by DWR under the Indenture with fixed rate refunding Bonds, (3) that current market conditions also make it likely that debt service savings can be achieved by the issuance of fixed rate refunding Bonds for the purpose of refunding a portion of its outstanding fixed rate Bonds, and (4) that in the case of each issuance of refunding Bonds described in clauses (2) and (3) of this paragraph it will be necessary or appropriate to enter into related Financing Documents and Enhancement Facilities, if any.

The Summary of Material Terms and the Previous Addenda specified certain matters which were reflected in the terms of the Financing Documents and addressed matters relating to the issuance or proposed issuance of Bonds in 2002, 2005, 2008 and 2010. This September 2010 Addendum addresses matters relating to the proposed issuance by DWR of the above-described refunding Bonds (the "Phase II 2010 Refunding Bonds"), including specifying that the Phase II 2010 Refunding Bonds are not subject to the maximum aggregate principal amount and proceeds limitations reflected in the Summary of Material Terms and the Previous Addenda and are instead subject to the limitations reflected herein and in the 2002 Rate Agreement. Except as provided herein, the Summary of Material Terms, as modified by the 2002 Addendum, shall apply, treating the Phase II 2010 Refunding Bonds as "Bonds" thereunder.

1. Maximum Amount of Phase II 2010 Refunding Bonds Authorized.

DWR will issue no more Phase II 2010 Refunding Bonds than it determines are necessary to provide for the defeasance and/or redemption of the Bonds being refunded and to pay costs incurred in connection with the issuance of the Phase II 2010 Refunding Bonds, the execution and delivery of the related Financing Documents (including Qualified Swap terminations, if any) and Enhancement Facilities, if any, and the defeasance and/or redemption of the Bonds being refunded. The principal amount of Phase II 2010 Refunding Bonds will also be limited as described in paragraph 3 below. All Phase II 2010 Refunding Bonds will be fixed rate and will be issued prior to December 31, 2010.

2. Use of Proceeds.

DWR will apply the proceeds of Phase II 2010 Refunding Bonds solely to fund an escrow providing for the defeasance and/or redemption of the Bonds being refunded and to the payment of costs incurred in connection with the issuance of the Phase II 2010 Refunding Bonds, the execution and delivery of the related Financing Documents (including Qualified Swap terminations, if any) and Enhancement Facilities, if any, and the defeasance and/or redemption of the Bonds being refunded. The Bonds to be refunded pursuant to this September 2010 Addendum will be determined by DWR, subject to the limitations of this September 2010 Addendum.

3. DWR Determinations as to Refundings.

Prior to the issuance of Phase II 2010 Refunding Bonds for the purpose of refunding fixed rate Bonds, DWR will furnish to the Commission DWR's determination that there are present value savings projected to result from the issuance of the Phase II 2010

Refunding Bonds for such purpose and the projected amount of such savings, which savings in the aggregate will not be less than 3% of the aggregate principal amount of the Bonds being refunded.

Prior to the issuance of Phase II 2010 Refunding Bonds for the purpose of refunding variable rate bonds, DWR will furnish to the Commission DWR's determination either (a) that there are present value savings projected to result from the issuance of such Phase II 2010 Refunding Bonds (taking into account all projected Bond-Related Costs related to the Phase II 2010 Refunding Bonds and the variable rate bonds being refunded), or (b) that it is necessary or desirable to refund unhedged variable rate Bonds because Enhancement Facilities are not available in sufficient amounts at reasonable fees and terms.

Each such determination will include a summary of the principal assumptions used in making such determination. The Department will, in the course of preparing to issue the Phase II 2010 Refunding Bonds and make such determination, provide to the Commission such information as the Commission may request concerning matters relating to such determination and the assumptions therein.

4. Rate Agreement Applicable to Phase II 2010 Refunding Bonds.

The Phase II 2010 Refunding Bonds shall be entitled to the benefits of the Rate Agreement in accordance with the terms thereof.