

RATE AGREEMENT

By and Between

STATE OF CALIFORNIA DEPARTMENT OF WATER RESOURCES

and

STATE OF CALIFORNIA PUBLIC UTILITIES COMMISSION

Dated as of February __, 2002

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RATE AGREEMENT, dated as of February __, 2002, by and between
STATE OF CALIFORNIA DEPARTMENT OF WATER RESOURCES and
STATE OF CALIFORNIA PUBLIC UTILITIES COMMISSION.

The parties mutually agree as follows:

ARTICLE I
DEFINITIONS

Section 1.1 Definitions. The terms set forth in this Section shall have the meanings ascribed to them herein for all purposes of this Agreement unless the context clearly requires otherwise. Words in the singular shall include the plural and words in the plural shall include the singular where the context so requires.

“Act” shall mean Chapter 4 of the Statutes of 2001 (AB 1 of the First 2001-02 Extraordinary Session) of the State, as amended from time to time.

“Agreement” shall mean this Rate Agreement, as from time to time hereafter amended or supplemented in accordance with the provisions hereof.

“Beneficiaries” shall mean, at any given time, the persons to whom the Department is then obligated to pay Bond Related Costs described in clauses (i) through (iv) of the definition of such term, in each case solely to the extent of such obligations.

“Bond Charge” shall mean a charge imposed by the Commission, by order promulgated as a result of this Agreement, upon customers in each of the Service Areas of Pacific Gas & Electric, Southern California Edison Company and San Diego Gas & Electric Company or any of their respective successors based on the aggregate amount of electric power sold to that customer by an Electrical Corporation and the Department, and to the extent determined under Section 4.3 hereof, by an Electric Service Provider, such charge to be revised from time to time by the Commission in such a manner that amounts on deposit in the Bond Charge Payment Account as a result of the charge are always sufficient to pay or provide for the payment of the Bond Related Costs; provided, that Bond Charges shall be imposed upon such customers in each Service Area at all times required by this Agreement whether or not the Department is at the time selling, or deemed to be selling, Power to such customers until such time as the Department has recovered the portion of the Department’s revenue requirements under Section 80134 of the Act constituting Bond Related Costs.

“Bond Charge Collection Account” shall have the meaning set forth in the Financing Documents. Revenues that the Department receives from Bond Charges shall be deposited in the Bond Charge Collection Account.

“Bond Charge Payment Account” shall have the meaning set forth in the Financing Documents. The primary purpose of the Bond Charge Payment Account is to hold amounts that the Financing Documents require to be periodically transferred from the Bond Charge Collection Account to provide for the payment of Bond Related Costs.

“Bond Related Costs” shall mean payments of, or deposits or other provision to be made by the Department under Financing Documents or the Act for the following components of the Department’s revenue requirements under Section 80134 of the Act:

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

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

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

(iv) the cost of Fiduciaries associated with the issuance and administration of the Bonds; and

(v) when and if the Department no longer sells Power under the Act and Bonds remain outstanding, the Department’s Bond Charge servicing costs, costs of preparing and providing the information and reports required under the Financing Documents, this Agreement and the Act, related audit, legal and consulting costs, related administrative costs, and costs of complying with arbitrage restrictions and rebate requirements.

“Bonds” shall mean State of California Department of Water Resources evidences of indebtedness issued for the purposes specified in the Act pursuant to Section 80130 of the Act and the Executive Order of the Governor of the State of California, dated June 18, 2001, in an aggregate principal amount up to \$ 13,423,000,000; provided, however, that (i) notes issued in anticipation of the issuance of Bonds and retired from the proceeds of those Bonds shall not be counted against said dollar limitation, and (ii) Bonds shall include indebtedness issued to refund prior Bonds, but such refunding indebtedness

shall not be counted against said dollar limitation; and, provided, further that, for all purposes of this definition, the Bonds shall exclude the Interim Loan.

“Commission” shall mean the State of California Public Utilities Commission and any board, commission, department, corporation, authority or officer succeeding to the functions thereof, or to whom the powers conferred on the Commission by the Act shall be given by law.

“Debt Service Reserve Account” shall have the meaning set forth in the Financing Documents. The purpose of the Debt Service Reserve Account is to provide for the payment of Bond Related Costs in the event that amounts in the Bond Charge Payment Account, after deposits from the Bond Charge Collection Account or other funds under the Indenture, are insufficient. The Debt Service Reserve Account is expected to be initially funded with Bond proceeds.

“Department” shall mean the State of California Department of Water Resources.

“Department Costs” shall mean, at any given time, all amounts which the Department is then entitled under Section 80110 of the Act to recover, as a revenue requirement, to enable it to comply with Section 80134 of the Act, (including amounts payable under the Interim Loan), except that Department Costs, unless specifically provided in this Agreement, exclude Bond Related Costs to the extent that such Bond Related Costs have been recovered from Bond Charges.

“Electrical Corporation” shall have the meaning ascribed thereto in Section 218 of the Public Utilities Code, including any successor and assign thereof.

“Electric Service Provider” shall mean an entity that provides electrical service to one or more retail customers located within the Service Areas of Pacific Gas & Electric, Southern California Edison Company, or San Diego Gas & Electric Company or any of their respective successors, except that Electric Service Provider excludes: the Department, any other public agency to the extent that it offers electrical service to customers within its jurisdiction or within the service territory of a local publicly owned electric utility, and Electrical Corporations. Electric Service Provider includes the unregulated affiliates and subsidiaries of an Electrical Corporation.

“Fiduciary” shall mean any Trustee, any bond registrar and any paying agent in connection with Bonds pursuant to the Financing Documents, and their respective successors and assigns.

“Financing Documents” shall mean any resolution, indenture, trust agreement, loan agreement, revolving credit agreement, reimbursement agreement, standby purchase agreement or other agreement or instrument adopted or entered into by the Department authorizing, securing or enhancing the Bonds, including any bond offering documents, as from time to time amended or supplemented in accordance therewith. Copies of all Financing Documents shall be provided to the Commission.

“Fund” shall mean the Department of Water Resources Electric Power Fund established by the Act.

“Interim Loan” shall mean obligations issued under the Credit and Security Agreement, dated as of June 26, 2001, among the Department and various lenders identified therein and Morgan Guaranty Trust Company of New York, in its capacity as agent for the lenders, and other documents and agreements described therein.

“Minimum Operating Reserve Account Requirement” shall have the meaning set forth in the Financing Documents, and shall include an amount solely limited to make payments due under the Priority Long Term Power Contracts if funds are not available in the Operating Account or the Priority Contract Account.

“Operating Account” shall have the meaning set forth in the Financing Documents. The purpose of the Operating Account is to provide for the payment of Department Costs, including by transfer to the Priority Contract Account. Power Charges will generally be deposited into the Operating Account.

“Operating Reserve Account” shall have the meaning set forth in the Financing Documents. The purpose of the Operating Reserve Account is to provide for the payment of Department Costs in the event that amounts in the Operating Account are insufficient, or amounts in the Priority Contract Account are insufficient to make payments due under the Priority Long Term Power Contracts.

“Power” shall have the meaning ascribed thereto in Section 80010 of the Water Code.

“Power Charges” shall mean charges imposed by the Commission upon Retail End Use Customers for electric power deemed sold to Retail End Use Customers by the Department, except that Power Charges exclude Bond Charges.

“Priority Contract Account” shall have the meaning set forth in the Financing Documents. The purpose of the Priority Contract Account is to provide solely for the payment of amounts due under Priority Long Term Power Contracts.

“Priority Long Term Power Contracts” shall mean (i) those long-term electric power contracts identified in Appendix A, and shall not include any electric power contracts entered into after August 14, 2001; provided, however, that such term shall include any priority long term electric power contract entered into after August 14, 2001, as an amendment or novation of any Priority Long Term Power Contract and (ii) any contracts entered into for the purpose of securing fuel for use at generating facilities being operated pursuant to such Priority Long Term Power Contracts, if that fuel supply contract contains a provision to the general effect that payments by the Department under the contract are to be paid or payable prior to bonds, notes, or other indebtedness of the Department secured by a pledge or assignment of the revenues of the Department under the Act and other amounts in the Fund. The Department shall consult with the Commission prior to entering into any additional contract for the purpose of securing fuel

if that contract contains such a provision. Contracts shall cease to be treated as Priority Long Term Power Contracts under the circumstances described in Section 7.8.

“Retail End Use Customer” shall mean each customer within the Service Area of an Electrical Corporation that is deemed to purchase electric power from the Department under the Act.

“Retail Revenue Requirements” shall mean the amounts required to pay Department Costs that are to be generated from Power Charges imposed by the Commission from time to time.

“Service Area” shall mean the geographic area in which an Electrical Corporation distributes electricity.

“State” shall mean the State of California.

“Trustee” shall mean any bank or trust company, or the State Treasurer, appointed as trustee, co-trustee or collateral agent in connection with the Bonds or bond related obligations pursuant to the Financing Documents, and its successors and assigns.

ARTICLE II REPRESENTATIONS AND WARRANTIES

Section 2.1 Representations and Warranties of Department. The Department makes the following representations and warranties as the basis for the undertakings on its part herein contained:

(a) It is a department within the Resources Agency of the State, validly existing under the Constitution and laws of the State, and has full power and authority to execute, deliver and perform and observe all of the terms and provisions of this Agreement.

(b) The execution, delivery and performance of this Agreement have been duly authorized by all necessary action on the part of the Department.

(c) This Agreement is a legal, valid and binding agreement of the Department and is enforceable against the Department in accordance with its terms.

Section 2.2 Representations and Warranties of Commission. The Commission makes the following representations and warranties as the basis for the undertakings on its part herein contained:

(a) It is a commission of the State, validly existing under the Constitution and laws of the State, and has full power and authority to execute, deliver and perform and observe all of the terms and provisions of this Agreement.

(b) The execution, delivery and performance of this Agreement, have been duly authorized by all necessary action on the part of the Commission.

(c) This Agreement is a legal, valid and binding agreement of the Commission and is enforceable against the Commission in accordance with its terms.

ARTICLE III AGREEMENTS FOR BOND ISSUANCE

Section 3.1 Agreement for Bond Issuance. The Department and the Commission agree that this Agreement is executed to facilitate the issuance of Bonds and solely for the benefit of the Beneficiaries.

Section 3.2 No Indebtedness. Nothing contained in the Agreement shall be deemed to create or constitute a debt or liability of the State or of any political subdivision thereof, or a pledge of the full faith and credit or taxing power of the State or of any such political subdivision.

Section 3.3 No Pecuniary Liability of Commission. Nothing in this Agreement shall be deemed to create any pecuniary liability of the Commission, its Commissioners, employees or agents to any person, the sole remedy for any default, breach or other nonperformance by the Commission hereunder being the exercise of remedies specifically afforded hereunder and under the Act.

ARTICLE IV RETAIL REVENUE REQUIREMENTS; JUST AND REASONABLE COSTS

Section 4.1 Retail Revenue Requirements.

(a) Generally. The Commission agrees to cooperate with and assist the Department in its review, determination and revision of its Retail Revenue Requirement at the request of the Department. The Department shall promptly notify the Commission following any determination or revision of the Retail Revenue Requirements. If any such annual or more frequent review indicates that the Power Charges are, or will be, insufficient to meet the requirements of the Act, and the Department so notifies the Commission, the Commission shall take necessary action to cure or avoid any such deficiency, including adjustment of existing, and the calculation and imposition of additional, Power Charges. To the extent that the Department has not provided a revised Retail Revenue Requirement to the Commission within the time periods required by subsection (b) below for any reason and the Commission determines based on the record before it, that Power Charges are not sufficient to pay Department Costs (which for this purpose include replenishment of the Bond Charge Collection Account, Bond Charge Payment Account or Debt Service Reserve Account), the

Commission may modify Power Charges to cover such shortfall on an interim basis pending receipt of a revised Retail Revenue Requirement from the Department.

(b) Communication. The Department shall, at least annually, and more frequently as deemed reasonably necessary or appropriate by the Department or the Commission, review, determine and revise its Retail Revenue Requirements. The Department agrees that it shall revise and communicate to the Commission its Retail Revenue Requirement within 20 days of the occurrence of any of the following circumstances, whether or not the Commission notifies the Department of such events: (i) the Department projects that, within 120 days, there will be insufficient funds in the Priority Contract Account to pay costs incurred by the Department under the Priority Long Term Power Contracts, or (ii) the Department projects that, within 120 days, there will be less than the Minimum Operating Reserve Account Requirement in the Operating Reserve Account, or (iii) the Department projects that, within 120 days, shortfalls in the Priority Contract Account, Operating Account and the Operating Reserve Account will require the usage of moneys in the Bond Charge Collection Account to pay costs incurred by the Department under the Priority Long Term Power Contracts, or (iv) the Department projects that, moneys in the Debt Service Reserve Account will be used within 120 days to pay Bond Related Costs. The Department further agrees that if a revised Retail Revenue Requirement has not previously been submitted pursuant to the preceding sentence of this Section 4.1 the Department shall revise and communicate to the Commission within 3 business days its Retail Revenue Requirement in the event that the Department makes any withdrawal from the Bond Charge Collection Account to pay specified Department Costs, or from the Operating Reserve Account or the Debt Service Reserve Account such that, in either case, the amount in such account is less than that required under the Financing Documents.

(c) Information. In any determination of the Retail Revenue Requirements, the Department shall include the amount required to be recovered in the applicable period and shall set forth amounts projected to be required to be collected during subsequent periods in which either Bonds will remain outstanding or the Department will continue to sell Power, but not exceeding the five years succeeding the applicable revenue requirement period. The Retail Revenue Requirements for any period shall take into account any deficiency or any surplus in amounts recovered in earlier periods, as well as any anticipated surpluses in the Priority Contract Account, Operating Account and the Operating Reserve Account in the period. The Department's notification to the Commission of the Retail Revenue Requirements shall include a statement containing the Department's projections (with reasonable detail) of the following information for each month during the period covered by the Retail Revenue Requirements:

(i) the beginning balance of funds on deposit in the Fund, including the amounts on deposit in each account and subaccount of the Fund;

(ii) the amounts necessary to pay or provide for the principal of, premium, if any, and interest on all Bonds and all other Bond Related Costs under the

Financing Documents as and when the same shall become due and the amount of Bond Charges to be collected for such purpose;

(iii) the amount of its Retail Revenue Requirement for that month;

(iv) any other information requested by the Commission in its proceedings implementing a Retail Revenue Requirement.

(d) Additional Information. The Department shall provide the Commission as soon as practicable, but no later than 30 days after the end of each month, a report of Department receipts and Department Costs for the prior month, based upon the sums of known actual Department receipts and Department Costs and estimated accruals for those receipts and costs which are subject to final invoicing or accounting settlement processes. Such monthly report shall be presented in a form which enables reasonable comparison to the monthly estimates contained in the latest Retail Revenue Requirement for (i) long term Department contract electric power purchases, (ii) short term Department electric power purchases, (iii) other electric power purchases or reimbursement by the Department of purchases of electric power by others for which the Department is responsible for payment, and (iv) Department administrative costs. For items (i), (ii) and (iii) above, the Department shall report information with a level of detail that lists each counterparty, the volumes provided by the counterparty, and the cost of those volumes. In addition, for those items, the costs and volumes will be separated into day ahead, hour ahead, "out of market" purchases, and contract categories, or such comparable categories as shall be in place at the time. The Department shall also report to the Commission on a monthly basis the balance in each of the accounts or subaccounts the Department is required to keep pursuant to the Financing Documents. When actual or additional information becomes available for any of the reports identified in this Section 4.1(d), the Department will communicate such information to the Commission. In addition, the Department's monthly reports shall contain the information required by Section 4.1(c)(ii).

(e) The Commission shall receive any financial reports prepared by the Department as required by the Financing Documents at the same time as the recipients under the Financing Documents.

Section 4.2 Just and Reasonable Costs. The Department agrees that prior to including any cost in the Retail Revenue Requirements communicated to the Commission in accordance with Section 4.1(a), the Department will conduct whatever procedures are required by law to determine that such cost is just and reasonable within the meaning of Section 451 of the California Public Utilities Code.

Section 4.3 ESP Power. Bond Charges may be based on electric power provided to customers by Electric Service Providers only after an order of the Commission providing for such charges becomes final and unappealable.

ARTICLE V
RATE COVENANT

Section 5.1 Rate Covenant.

(a) The Commission hereby covenants and agrees to calculate, revise and impose from time to time, Bond Charges sufficient to provide moneys so that the amounts available for deposit in the Bond Charge Payment Account from time to time, together with amounts on deposit in the Bond Charge Payment Account, are at all times sufficient to pay or provide for the payment of all Bond Related Costs when due in accordance with the Financing Documents.

(b) As provided by Section 80112 of the Act and as authorized by Section 80110 of the Act, including by reference to Article 5.5 (commencing with Section 840) of Chapter 4 of Part 1 of Division 1 of the California Public Utilities Code, the Bond Charges authorized by Commission Order and the right of the Department to receive Bond Charges as provided in this Agreement shall be property of the Department for all purposes under California law.

(c) As authorized by Section 80110 of the Act by reference to Article 5.5 (commencing with Section 840) of Chapter 4 of Part 1 of Division 1 of the California Public Utilities Code, Sections 5.1(a) and 5.1(b) of this Agreement shall have the force and effect of a “financing order” adopted thereunder and shall be irrevocable and enforceable in accordance with the terms hereof, including, without limitation, in circumstances in which the Department has breached its obligations under this Agreement or in respect of the Financing Documents.

(d) If the Department has complied with Article IV hereof to the extent applicable, but nevertheless projects that there will be insufficient monies on deposit in the Bond Charge Payment Account to make timely payment of Bond Related Costs, the Department shall submit to the Commission a request that the Commission increase Bond Charges to make timely payment of Bond Related Costs and the Commission agrees that it shall calculate and impose revised Bond Charges to pay such Bond Related Costs no later than 120 days from the date following the delivery to the Commission by the Department of its request for revised Bond Charges, provided, to the extent the insufficiency in the Bond Charge Payment Account relates to an insufficiency of Power Charges to provide for certain specified Department Costs, the Commission agrees that, no later than 120 days from the date on which the Department submits a revised Retail Revenue Requirement pursuant to Article IV covering the same projected insufficiency in the Bond Charge Payment Account, it shall respond to the revised Retail Revenue Requirement or the Bond Charge request. Whether or not the Department makes the foregoing requests, the Commission shall, in all instances, be bound by its covenants in this Article V.

**ARTICLE VI
COVENANTS OF THE COMMISSION**

Section 6.1 Power Charges.

(a) The Commission hereby covenants and agrees to calculate, revise and impose, from time to time, Power Charges sufficient to provide moneys in the amounts and at the times necessary to satisfy the Retail Revenue Requirements as specified by the Department.

(b) Power Charges and Bond Charges shall be established by the Commission without regard to the levels or amounts of any particular rates or charges authorized by the Commission to be charged by any Electrical Corporation for electrical power sold by such Electrical Corporation.

(c) The Commission acknowledges that, as provided by Section 80112 of the Act, Power Charges shall be property of the Department for all purposes under California law.

(d) The Commission agrees that it shall calculate and impose Power Charges no later than 120 days following the delivery to the Commission by the Department of a statement of new or revised Retail Revenue Requirements that complies with Article IV hereof.

Section 6.2 Compliance with Agreement.

(a) The Commission hereby covenants with the Department that the Commission shall take all such actions or refrain from taking all such actions, as the case may be, so as to comply with the terms and provisions of the Act and this Agreement.

(b) The Commission hereby covenants that, so long as any Bonds shall be outstanding, it will not take any action, or fail to take any action, which, if taken or not taken, as the case may be, would adversely affect the tax-exempt status of the interest payable on Bonds or Interim Loan obligations then outstanding, the interest on which, at the time of issuance thereof, was exempt from Federal income taxation or not includable in gross income for purposes of Federal income taxation. In furtherance of the foregoing, the Commission agrees to act with respect to those matters within its control that could adversely affect the exclusion of interest on Bonds or Interim Loan obligations from gross income for purposes of federal income taxation.

Section 6.3 Liens. Until the Bonds have been paid in full or provision has been made therefor in accordance with the Financing Documents, the Commission, to the extent it has the power to do so, shall not permit to be created any purported lien upon or pledge of the Power Charges or the Bond Charges except any lien and pledge thereon created by or pursuant to the Act as security for the enforcement of the Department's obligations (including the Interim Loan) entered into pursuant thereto.

Section 6.4 Commission Acknowledgment. The Commission acknowledges that the Department intends to enter into Financing Documents that permit certain specified Department Costs to be funded out of amounts available in the Bond Charge Collection Account if insufficient moneys are available in the Priority Contract Account, Operating Account and the Operating Reserve Account to pay such specified Department Costs. In the event that such Department Costs are funded out of the Bond Charge Collection Account, the Department shall take such actions as are required under this Agreement so that the amounts applied from the Bond Charge Collection Account for such purpose shall be replenished from Power Charges, provided that any failure to do so by the Department shall not mitigate or alter the Commission's obligations under Article V.

ARTICLE VII COVENANTS OF THE DEPARTMENT

Section 7.1 Retail Revenue Requirement. The Department hereby covenants and agrees to calculate and revise its Retail Revenue Requirement only for the purpose of recovering costs which it is permitted to collect under the Act, (including amounts payable under the Interim Loan), and not to cover any costs in connection with its responsibilities under the Act which it cannot include in such a Retail Revenue Requirement.

Section 7.2 Department Participation. Consistent with the limitations set forth in Water Code Section 80110, upon the request of the Commission, the Department will participate in any Commission proceedings, including providing witnesses, attending public hearings and providing any other materials necessary to facilitate the Commission's completion of its proceedings, taken in connection with the establishment of Power Charges or Bond Charges by the Commission.

Section 7.3 Compliance with Agreement.

(a) The Department hereby covenants with the Commission that the Department shall take all such actions or refrain from taking all such actions, as the case may be, so as to comply with the terms and provisions of the Act and this Agreement, including but not limited to, complying with the legal requirements referenced in Article IV and the requirement to review its Retail Revenue Requirement at least annually.

(b) The Department hereby covenants that, so long as any Bonds shall be outstanding, it will not take any action, or fail to take any action, which, if taken or not taken, as the case may be, would adversely affect the tax-exempt status of the interest payable on Bonds or Interim Loan obligations then outstanding, the interest on which, at the time of issuance thereof, was exempt from Federal income taxation or not includable in gross income for purposes of Federal income taxation. In furtherance of the foregoing, the Department agrees to act with respect to those matters within its control

that could adversely affect the exclusion of interest on Bonds or Interim Loan obligations from gross income for purposes of federal income taxation.

Section 7.4 Charges. The Department acknowledges the Commission's exclusive authority to spread the Department's revenue requirement among customer classes and service territories and to determine the extent or timing of rate changes that may be required in the future, consistent with the Commission's obligations in this Rate Agreement. As long as this Agreement is in effect the Department agrees that it will not attempt to fix or establish charges on retail end use customers for the purpose of paying Department Costs or Bond Related Costs. Nothing in this Agreement shall be read to establish that the Department does or does not have the authority to fix or establish such charges.

Section 7.5 Department Audits. The Department shall provide to the Commission when available a copy of any audit conducted pursuant to Section 80270 of the Act and a copy of each of the Department's audited annual financial statements for the Fund.

Section 7.6 Proceeds. The Department shall sell Bonds, as soon as practicable, in amounts sufficient to provide for the repayment to the General Fund of the State of the advances made under the Act to the Fund, together with interest on such advances as provided by the Act. The Department shall apply the proceeds of the Bonds to repayment of the General Fund with the understanding that repayment of the Interim Loan in full has priority and that the following costs may have priority: creation of adequate reserves for the payment of Bond Related Costs and payment of costs of issuance.

Section 7.7 Renegotiation of Power Contracts. The Department shall use its best efforts to renegotiate or modify its long term Power contracts.

Section 7.8 Priority Long Term Power Contracts. Any Priority Long Term Power Contract that is amended, replaced or terminated so that any resulting contract no longer contains a provision to the general effect that payments by the Department under the contract are to be paid or payable prior to bonds, notes, or other indebtedness of the Department secured by a pledge or assignment of the revenues of the Department under the Act and other amounts in the Fund shall no longer be treated as a Priority Long Term Power Contract. The Department shall immediately notify the Commission of any such amendment, replacement or termination.

Section 7.9 Appointment of Trustee. To the extent practicable, the Department shall appoint as Trustee a bank, trust company or other qualified entity or person that does not itself, or by or through any of its corporate affiliates, trade in electricity or natural gas commodity markets, and does not itself, or any of its affiliates, appear on the list of top twenty creditors for any Electrical Corporation or any entity providing electric power to the Department that has petitioned for bankruptcy.

Section 7.10 Financing Documents. The Department shall involve, to the fullest extent possible, the Commission in the development and completion of all Financing Documents and shall consult with the Commission on the sizing of operating and debt service reserves, debt service coverage, the maturity and maximum amount of Bonds to be issued and any other matters in the Financing Documents which the Commission deems material. The Department has submitted to the Commission a summary (the “Summary”) of the material terms of the Financing Documents securing its Bonds. (“Material terms” means the maximum amount of the Bonds authorized, their maturity, a description of the flow of funds and a description of the sizing or methodology of sizing of reserves held or created pursuant to the Financing Documents or debt service coverage required thereby.) If the Department makes any material change to any such terms it must obtain the approval of the Commission’s designee. For purposes of the last sentence, “material change” means (i) a change in the sizing or methodology of sizing of debt service reserves that would increase the projected net debt service on the Bonds by more than an amount specified in the Summary; (ii) an increase in debt service coverage required by the Financing Documents by more than an amount specified in the Summary; (iii) a change in the sizing or method of sizing of operating reserves by more than an amount specified in the Summary; (iv) any increase in the maximum amount of the Bonds authorized; (v) a change in the maturity of the Bonds beyond those changes permitted in the Summary; or (vi) a change in the flow of funds beyond those changes permitted in the Summary. At the time the Commission adopts the Rate Agreement, it will appoint a designee for purposes of this Section 7.10. Nothing in this Section 7.10 shall imply that the Commission or its designee shall have the right to approve (i) the final amortization, interest rates, or methods of determination, denominations, redemption provisions or pricing of the Bonds or (ii) final sizing of reserves and debt service coverage based on pricing considerations, or (iii) except to the extent set forth above in this Section 7.10, the terms of any revolving credit agreement, reimbursement agreement, standby purchase agreement, liquidity or credit enhancement facility, or swap agreement or other hedging agreement entered into in connection with the Bonds, or (iv) any agreements or arrangements with any Fiduciary incident to the issuance of the Bonds or (v) any offering document used in connection with the offering of the Bonds (except with respect to sections of the offering document relating to the Commission.)

ARTICLE VIII EVENTS OF DEFAULT AND REMEDIES

Section 8.1 Events of Default. An “event of default” or a “default” shall mean, whenever they are used in this Agreement, a failure of the Commission to calculate and impose Bond Charges in accordance with Article V.

Section 8.2 Remedies.

(a) Whenever any event of default shall have occurred and be continuing, and written notice of the default shall have been given to the Commission by the Department and the default shall not have been cured within 30 days, the Department

may take whatever action at law or in equity may appear necessary or desirable to enforce performance and observance of any obligation, agreement or covenant of the Commission under Article V.

(b) Whenever any event shall have occurred and be continuing, such that either the Commission or the Department is not in compliance with any covenant or obligation of this Agreement, and written notice of the breach of such covenant or obligation shall have been given to either the Commission or the Department and the breach shall not have been cured within 30 days, both the Commission or the Department may take whatever action at law or in equity that may appear necessary or desirable to enforce performance and observance of any obligation, agreement or covenant under this Agreement.

Section 8.3 Consent to Assignment.

(a) The Commission consents to the collateral assignment by the Department to the Trustee for the benefit of the Beneficiaries, as such, of the covenants of the Commission contained in Article V; provided, however, that any rights so granted to the Trustee shall not be greater than the rights of the Department under such Sections of this Agreement, and such right on the part of the Trustee to enforce such covenants shall only commence after the Department has both defaulted under its obligations contained in the Financing Documents and has failed to enforce such covenants in accordance with the terms of this Agreement. Prior to exercising any rights granted to the Trustee in accordance with this Section 8.3, the Trustee shall be required to (i) give prior written notice within the time period required in Section 8.3(b) below, (ii) certify to the Commission that an event of default, other than an event of default predicated solely on the Commission's failure to act hereunder, has occurred under the Financing Documents and (iii) comply or cause the Department to comply with the provisions of this Agreement relating to the Department's rights, duties and obligations hereunder.

(b) In addition to the requirements of Section 8.3(a) for exercising its rights hereunder, unless a default has resulted in the amount in the Debt Service Reserve Account being insufficient to pay or provide for the timely payment of all Bond Related Costs in accordance with the Financing Documents, the Trustee shall give the Commission 30 days prior written notice of the exercise by the Trustee of any of the Department's rights under Section 5.1 hereof.

ARTICLE IX TERMINATION

Section 9.1 Termination. The Agreement shall terminate, and the covenants and other obligations contained in the Agreement shall be discharged and satisfied, when payment of the Bonds and all other Bond Related Costs required to be paid by the Department under the Financing Documents have been made or provided for in accordance with the Financing Documents.

ARTICLE X AMENDMENTS

Section 10.1 Amendments to Agreement. No amendment to the Agreement shall be effective unless it is in writing and signed by each of the parties hereto, provided, however, on or after the issuance of the Bonds, Sections 5.1(a) and (b) may not be amended.

ARTICLE XI MISCELLANEOUS

Section 11.1 No Waiver. No failure to exercise, and no delay in exercising by the parties hereto, any right, power or privilege hereunder shall operate as a waiver thereof; nor shall any single or partial exercise of any right, power or privilege hereunder preclude any other or further exercise thereof, or the exercise of any right, power or privilege. The rights and remedies herein provided are cumulative and not exclusive of any rights or remedies provided by law, including the Act.

Section 11.2 Notices. All notices, requests and other communications under this Agreement shall be deemed to have been duly given if in writing and delivered personally or by certified mail (a) to the Department at 1416 9th Street, 11th Floor, Sacramento, California 95814, attention: Director; (b) to the Commission at 505 Van Ness Avenue, San Francisco, California 94102, attention: Executive Director and General Counsel; or such other address as the Department, or the Commission, as the case may be, shall hereafter designate by notice in writing to the other party.

Section 11.3 Severability. In the event that any one or more of the provisions contained in the Agreement is or are invalid, irregular or unenforceable in any respect, the validity, regularity and enforceability of the remaining provisions contained in this Agreement shall be in no way affected, prejudiced or disturbed thereby.

Section 11.4 Headings. The descriptive headings of the several articles of the Agreement are inserted in the Agreement for convenience only and shall not be deemed to affect the meaning or construction of any of the provisions of the Agreement.

Section 11.5 Governing Law. The Agreement shall be governed by, and construed in accordance with, the Constitution and laws of the State of California, without regard to the provisions thereof regarding conflicts of law.

Section 11.6 Counterparts. This Agreement may be executed in several counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument.

Section 11.7 Date of Agreement. The date of this Agreement shall be for identification purposes only. This Agreement shall become effective immediately upon execution and delivery by the parties hereto.

Section 11.8 Third Party Beneficiaries. Nothing in this agreement express or implied shall be construed to give any person or entity, other than the parties hereto and the Beneficiaries, any legal or equitable right, remedy, or claim under or in respect of the agreement or any covenants, agreements, representations, or provisions contained herein.

Section 11.9 Applicability. This Agreement does not apply to any Retail Revenue Requirement under consideration by the Commission as of the date of this Agreement, but does apply to any Retail Revenue Requirement submitted thereafter. Prior to the issuance of any Bonds, any provision of this Agreement referring to an account or subaccount under the Financing Documents shall be interpreted to achieve the intent of such provision as nearly as practicable.

Section 11.10 No Implied Waivers. Nothing in this Agreement shall be construed to limit the rights of the Commission or the Department to assert any rights it may have with respect to any contract entered into by the Department with respect to its obligations under the Act, or to contest in any proceeding the legality or effect of any contract entered into by the Department with respect to its obligations under the Act.

Section 11.11 No Assignment. Except as set forth in Section 8.3, neither the Department nor the Commission shall assign any of its rights or delegate any of its duties under this Agreement without the express written consent of the other party hereto, provided, however, if , with respect to either party, another governmental entity is created or designated by law to carry out the rights, powers, duties and obligations of such party, then such party may, if required by such law, transfer and assign its right, title and interest in this Agreement to such successor, provided, that such successor entity is permitted by law to assume such party's obligations under this Agreement and agrees in writing to be bound by the terms of this Agreement.

IN WITNESS WHEREOF, the Department has caused this Agreement to be executed in its name by the Director of Water Resources and the Commission by the affirmative vote of the Commission (Decision No. 02-02-051) has caused this Agreement to be executed in its name by those Commissioners who constituted a majority of the Commission when it approved this agreement, all as of the date first above written.

**STATE OF CALIFORNIA
DEPARTMENT OF
WATER RESOURCES**

By: _____
Director of Water Resources

**STATE OF CALIFORNIA PUBLIC
UTILITIES COMMISSION**

By: _____
Commissioner

By: _____
Commissioner

By: _____
Commissioner

By: _____
Commissioner

By: _____
Commissioner