DEPARTMENT OF WATER RESOURCES
CALIFORNIA ENERGY RESOURCES SCHEDULING
P.O. BOX 219001
3310 EL CAMINO AVENUE, SUITE 120
SACRAMENTO, CA 95821-9001
(916) 574-1291

March 12, 2008

Lionel B. Wilson, Esq.
Interim General Counsel
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, California 94102

Dear Mr. Wilson:

As stated in my February 27, 2008 letter, the Department of Water Resources (DWR) has determined that current market conditions make it necessary and appropriate to reduce DWR's exposure to market uncertainties relating to the credit ratings of the bond insurance companies and mitigate the interest rate risk associated with insured variable rate bonds.

In its first step to reduce its exposure to insured variable rate bonds, DWR is selling fixed rate bonds this week to refund all of DWR's $500 million in "auction rate" bonds and approximately $500 million of its "variable rate demand" bonds. DWR has remaining approximately $825 million of "variable rate demand" bonds that are currently exposed to interest rate risk associated with bond insurance companies. DWR expects to mitigate this remaining interest rate risk associated with bond insurers by issuing variable rate bonds that are backed by direct pay letters of credit. If sufficient bank letter of credit capacity is not available to issue the entire $825 million of new bonds as variable rate bonds, the remaining bonds will be sold as fixed rate bonds.

DWR plans to implement this second transaction so long as current market conditions continue. As they did in this week's transaction, DWR's financial advisory firm, Montague DeRose and the State Treasurer's Office will participate in this follow-on transaction.

Under Section 7.10 of the Rate Agreement between DWR and the California Public Utilities Commission (Commission), DWR submitted a Summary of Material Terms of the bonds and various Addendums to the Summary of Material Terms to the Commission. (Latest addendum attached.) In brief, the issuance of variable rate debt, rather than fixed rate debt, to refund the remaining variable rate demand bonds exposed to interest rate risk associated with bond insurance companies would be a material change in the type of debt described in the Summary and Addendums, resulting in the need for the Commission to authorize its designee to approve such change.

Please contact Jim Olson, Chief, Financial Management Office at (916) 574-1297 or me at (916) 574-2733 if there are any questions.

Sincerely,

John Pacheco

for Timothy J. Haines
Deputy Director

Attachment

cc: (See attached list)

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

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

Honorable Rachelle Chong, Commissioner
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, California 94102

Honorable Dian M. Grueneich, Commissioner
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, California 94102

Honorable Timothy Alan Simon, Commissioner
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, California 94102

Mr. Joel T. Perlstein, Esq.
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, California 94102

THIS MARCH 2008 ADDENDUM TO SUMMARY OF MATERIAL TERMS OF FINANCING DOCUMENTS, dated as of March 12, 2008 (the "March 2008 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 an Amended and Restated Addendum to Summary of Material Terms dated as of August 8, 2002 (the "2002 Addendum"), an Addendum to Summary of Material Terms of Financing Documents dated as of September 20, 2005 (the "2005 Addendum"), and an Addendum to Summary of Material Terms of Financing Documents dated as of February 27, 2008 (the "February 2008 Addendum, and collectively with the 2002 Addendum and the 2005 Addendum, the "Previous Addenda"). All undefined terms in this March 2008 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.

DWR has determined (1) that current market conditions make it necessary and appropriate to reduce DWR's exposure to market uncertainties relating to the credit ratings of the bond insurance companies and to mitigate DWR's interest rate risk associated with certain of its insured variable rate demand Bonds, and (2) that it can achieve those objectives by refunding such Bonds with variable rate demand Bonds for which credit enhancement will initially be provided by bank letters of credit.

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 and 2008. This March 2008 Addendum addresses matters relating to the proposed issuance by DWR of the above-described variable rate refunding Bonds (the "2008 Variable Rate Refunding Bonds"), including specifying that the 2008 Variable Rate 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.

1. Maximum Amount of 2008 Variable Rate Refunding Bonds Authorized.

DWR will issue no more 2008 Variable Rate Refunding Bonds than it determines are necessary to provide for the defeasance of the variable rate Bonds being refunded and to pay costs incurred in connection with the issuance of the 2008 Variable Rate Refunding Bonds, the execution and delivery of the related Financing Documents and Enhancement Facilities, if any, and the defeasance and redemption of the Bonds being refunded, provided that the aggregate principal amount of 2008 Variable Rate Refunding Bonds which may be issued pursuant to this March 2008 Addendum will not exceed $1,340,000,000 minus the aggregate principal amount of 2008 Fixed Rate Refunding Bonds issued pursuant to the February 2008 Addendum to refund variable rate demand Bonds (including any such 2008 Fixed Rate Refunding Bonds that may be issued pursuant to the February 2008 Addendum at the same time as 2008 Variable Rate Refunding Bonds).

2. Use of Proceeds.

DWR will apply the proceeds of 2008 Variable Rate Refunding Bonds solely to fund an escrow providing for the defeasance of the Bonds being refunded and to the payment of costs incurred in connection with the issuance of the 2008 Variable Rate Refunding

Bonds, the execution and delivery of the related Financing Documents and Enhancement Facilities, if any, and the defeasance and redemption of the Bonds being refunded. The Bonds to be refunded pursuant to this March 2008 Addendum will be determined by DWR and will be selected by DWR from among its insured variable rate demand Bonds.

3. Rate Agreement Applicable to 2008 Variable Rate Refunding Bonds.

The 2008 Variable Rate Refunding Bonds shall be entitled to the benefits of the Rate Agreement in accordance with the terms thereof.