

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Application of California-American Water
Company (U210W) for Approval of the
Monterey Peninsula Water Supply Project and
Authorization to Recover All Present and Future
Costs in Rates.

A.12-04-019
(Filed April 23, 2012)

**SETTLING PARTIES' MOTION TO APPROVE
SETTLEMENT AGREEMENT**

[SETTLEMENT AGREEMENT ATTACHED]

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I. INTRODUCTION

Pursuant to Rule 12.1(a) of the Rules of Practice and Procedure of the California Public Utilities Commission, California-American Water Company (“California American Water” or the “Company”), Citizens for Public Water,¹ City of Pacific Grove, Coalition of Peninsula Businesses, County of Monterey (the “County”), Division of Ratepayer Advocates (“DRA”), Landwatch Monterey County (“LandWatch”), Monterey County Farm Bureau (“MCFB”), Monterey County Water Resources Agency (“MCWRA”), Monterey Peninsula Regional Water Authority (“MPRWA”), Monterey Peninsula Water Management District (“MPWMD”), Monterey Regional Water Pollution Control Agency (“MRWPCA”), Planning and Conservation League Foundation, Salinas Valley Water Coalition (“SVWC”), Sierra Club, and Surfrider Foundation (“Surfrider”) (collectively, “the Parties”) submit this motion requesting that the Commission adopt and approve the accompanying Settlement Agreement, included as “Attachment A.”²

¹ Due to a communication difficulty, it was not possible to obtain a signature from George Riley on behalf of Citizens for Public Water. Mr. Riley expressed his willingness to sign the agreement; however, we had not received the signed agreement by the time this motion had to be filed with the Commission.

² A separate settlement agreement on the sizing of the desalination plant has been entered by certain parties. A motion to adopt that settlement agreement is filed concurrently.

The Parties mutually and jointly support the proposed Settlement Agreement as reasonable, consistent with the law, and in the public interest. The Settlement Agreement provides for the development, construction, operation and financing of the Monterey Peninsula Water Supply Project (“MPWSP”), as well as the recovery of the costs in rates. The Agreement resolves most of the contested issues in this proceeding and enjoys the support of a broad coalition of parties representing diverse interests, from environmental to business, public to private entities, utilities to ratepayers. The Parties request that the Commission, in ruling on this motion, approve the Settlement Agreement without modification, grant, with certain conditions, California American Water a certificate of public convenience and necessity (“CPCN”) for the MPWSP, and authorize recovery of costs in rates.

II. BACKGROUND

On April 23, 2012, California American Water Company filed an application for a CPCN for the MPWSP and authorization to recover all present and future costs in rates. The purpose of the MPWSP is to replace a significant portion of the existing water supply from the Carmel River, as directed by the State Water Resources Control Board (“SWRCB”). Acquisition of an alternative water supply is necessary for California American Water to comply with SWRCB Order No. WR 95-10 (“Order 95-10”), which directed California American Water to develop and implement a plan to replace what the SWRCB determined to be unlawful diversions from the Carmel River. On October 20, 2009, the SWRCB issued a Cease and Desist Order (“CDO”) (Order No. WR 2009-0060), which requires California American Water to undertake additional measures to reduce its unpermitted diversions from the Carmel River and to terminate all diversions in excess of 3,376 acre feet per year.

The MPWSP will consist of slant intake wells, brackish water pipelines, the desalination plant, product water pipelines, brine disposal facilities, and related appurtenant facilities. The MPWSP also incorporates facilities that the Commission previously approved in D.10-12-016 (referred to as the “CAW-Only Facilities”). These facilities consist of the Transfer Pipeline, the Seaside Pipeline, the Monterey Pipeline, the Terminal Reservoir, the Aquifer

Storage and Recovery (“ASR”) Pipeline, the ASR Recirculation and Backflush Pipelines, the ASR Pump Station and the Valley Greens Pump Station.

California American Water’s application initially sought authorization to size the MPWSP desalination plant at 9.0 million gallons per day (“mgd”), but also requested authorization to reduce the plant size to 5.4 mgd and supplement water supplies with water purchased from the Groundwater Replenishment Project (“GWR Project”), a joint project of MRWPCA and MPWMD, if the GWR Project reaches certain milestones by the time California American Water is ready to construct the desalination plant, and the cost of GWR Project water is reasonable. In response to comments from interested parties, California American Water updated the proposed plant sizes to 9.6 mgd without the GWR Project and 6.4 mgd with the GWR Project.³ The smaller 6.4 mgd option is premised on the availability of 3,500 acre-feet-per year (“af/yr”) from the GWR Project. After further negotiations between the Parties, it was agreed that if the GWR Project can secure only 3,000 af/yr of water, then the plant would need to produce an additional 500 af/yr above the smaller version.

Workshops on project costs, contingencies, and financial modeling were held on December 11-13, 2012. California American Water served supplemental testimony on January 11, 2013. DRA and intervenors served testimony on February 22, 2013. California American Water served rebuttal testimony on March 8, 2013. Evidentiary hearings were held on April 2-11, 2013 and April 30-May 2, 2013.

Notice of an all-party settlement meeting was served by the MPRWA on April 18, 2013. The all-party settlement meeting was held on April 30, 2013 at the Commission. Settlement discussions continued through May, June, and July 2013. A GWR workshop took place at the Commission on June 12, 2013.

III. OVERVIEW OF THE SETTLEMENT AGREEMENT

As noted above, the Settlement Agreement resolves most of the issues in this

³ *Supplemental Testimony of Richard C. Svindland* (Jan. 11, 2013), at p. 5.

proceeding. Through the Settlement Agreement, the Parties affirm their belief that, consistent with Public Utilities Code Section 1002(a), the MPWSP will serve the public convenience and necessity.⁴ On that basis, they support granting the CPCN, with certain conditions, subject to the terms and conditions of the Settlement agreement, including, for example, review under California’s Environmental Quality Act (“CEQA”), findings required by Public Resources Code Section 21081, and resolution of plant sizing. With the pending CDO deadline, time for implementing the MPWSP is of the essence.

The major aspects of the Settlement Agreement are as follows:

A. Groundwater Replenishment Project

Through the Settlement Agreement, the Parties agree the Commission will decide whether to authorize California American Water to build (1) a smaller desalination plant combined with a water purchase agreement (“WPA”) for GWR Project water, or (2) the larger desalination plant not combined with GWR. This determination is referred to as the “GWR Decision.” The Decision shall rest on findings concerning schedule, cost, benefits, and feasibility of GWR outlined in the Settlement Agreement. As the information necessary to reach those findings is not yet available, the GWR Decision should be made in a separate phase of the proceeding to occur promptly after all or most of that information is available. The Parties, therefore, will file a joint motion to bifurcate that decision into a separate phase and propose a specific schedule for that phase. That schedule is detailed in the Settlement Agreement.

In the separate phase, the Commission should make the GWR Decision based on whether it can make the necessary findings and/or certain information can be supplied through the advice letter process.⁵ If all findings are made or addressed through advice letters, the

⁴ Support by five of the sixteen Parties is contingent on the resolution of certain issues. Surfrider’s support is contingent on resolving brine discharge to include a pressurized diffuser. SVWC, MCFB, LandWatch, and Citizens for Public Water are concerned about potential harm from California American Water’s production of source water to the Salinas River Groundwater Basin (“SRGB”) and its users. Their CPCN support is therefore contingent on resolving certain source water issues to be informed by the Hydrogeologic Study and the Technical Report provided for in the Settlement Agreement.

⁵ While the Commission should be able to adopt findings supporting the GWR Decision by the end of the separate phase, some necessary actions may not have occurred or information may not be available by that point. To accommodate such circumstances, California American Water may file advice letters with the Commission

smaller plant will be built and combined with GWR; if they are not made or addressed through advice letters, the larger plant will be built. The findings concern whether: (1) the GWR Project receives approval pursuant to a Final EIR, (2) adequate progress was made and is expected to continue for obtaining permits for the GWR Project, (3) sufficient legal certainty exists concerning long-term viability for GWR source water, (4) there is a lack of evidence showing health and water quality regulators will deny permits or approval, (5) the GWR Project is on schedule for completion, (6) the GWR Project's design is at the required level, (7) a sufficiently detailed funding plan is in place, (8) terms to a Water Purchase Agreement ("WPA") have been agreed to, and (9) the revenue requirement for the combination smaller plant/GWR is just and reasonable compared with the larger plant. A revenue requirement premium for the combination smaller plant/GWR may be just and reasonable if the combination affords significant benefits (including scheduling, diversification of water supply, and environmental benefits) over the larger plant.

Finally, the WPA could commit a significant amount of California American Water's future cash flows. Thus, accountants and/or ratings agencies may view the WPA, among other things, as a capital lease or as imputed debt. This could significantly impact the Company's financials and possibly its debt ratios, or it could harm its credit rating. The Commission, therefore, shall determine the impact of such possibilities.

B. Hydrogeologic Study

In the Settlement Agreement, the Parties agree California American Water and SVWC's hydrologists and technical teams will work with other experts designated by those entities (collectively, the "Technical Group") to develop a joint work plan, consistent with SWRCB recommendations, for the MPWSP's proposed source water intake sites. The work plan will be the Technical Group's agreement on the process and procedures for obtaining information on the MPWSP's impact, if any, on the SRGB and its users ("Hydrogeologic

demonstrating that actions (such as MRWPCA's approval of the GWR Project and execution of the WPA) have occurred.

Study”). The parties consent to this process to avoid litigation over the scope and methodology of the Hydrogeologic Study and related reports. California American Water will implement and carry out the Hydrogeologic Study as soon as feasible.

During and after completion of the Hydrogeologic Study, the Technical Group will evaluate Study data and results, ultimately preparing a report with its findings (the “Technical Report”).⁶ After carefully considering the Technical Report, and working with the Technical Group, California American Water will focus its production from a shallow portion of the aquifer system, sometimes referred to as the Sand Dunes Aquifer, and pursue a source water project, to the extent feasible, most consistent with the Technical Report and Technical Group’s recommendations.

C. The Desalination Plant and CAW-Only Facilities

In connection with the design and location of the desalination plant, the Parties agree, among other things, the following are reasonable: (1) use of subsurface intake slant wells, if feasible; (2) use of a partial second pass on the plant’s reverse osmosis system to ensure Department of Public Health boron rejection goals are met;⁷ (3) use of specified pipe for the intake pipeline;⁸ (4) purchase of the 46-acre Charles Benson Road parcel for the plant;⁹ (5) locating the plant north of Marina because the geology for slant wells is promising, it is close to an existing marine outfall, and it is near a landfill that may provide for additional power options;¹⁰ and (6) movement of the slant test well and potentially full production well field to the active mining area of Cemex's Lapis Road facility.

Based on currently available information, the Parties agree estimates of \$210.6 million for a 6.4 mgd option, \$214.08 for a 6.9 mgd option, and \$253.36 million for a 9.6 mgd

⁶ The Parties agree that MCWRA’s authority with respect to the SRGB is not affected by the Hydrogeologic Study and Technical Report.

⁷ *Rebuttal Testimony of Richard C. Svindland* (March 8, 2013) (“Svindland Rebuttal”), at p. 10; *Rebuttal Testimony of Eric J. Sabolsice* (March 8, 2013), at pp. 6-7.

⁸ The specified pipe should be high density polyethylene (HDPE) pipe with an inner diameter of 36 inches. Svindland Rebuttal, pp. 12-13.

⁹ CA-21, Svindland Rebuttal, p. 9; PW-1, *Direct Testimony of George T. Riley for Citizens For Public Water* (Feb. 21, 2013), at pp. 7-8.

¹⁰ CA-21, Svindland Rebuttal, p. 9.

option provide a reasonable basis for the Commission to reach a decision and reasonable cost caps.¹¹ Likewise, the Parties agree an \$85.04 million cost estimate and cap for the CAW- Only Facilities is reasonable. DRA heavily scrutinized the cost estimates and models. And California American Water provided testimony in response. Only after such a detailed and critical review did the Parties reach a settlement of these issues which is just and reasonable in light of the record. California American Water may seek recovery for reasonable and prudent costs for limited amounts above the caps by filing a Tier 2 advice letter. For costs above those limited amounts, the Company will file a petition for modification.¹²

California American Water will establish a memorandum account to separately track costs for the desalination facilities and CAW-Only Facilities and to accumulate Surcharge 2 funds in excess of the \$35.1 million to be first credited against spending on the CAW-Only Facilities. CAW-Only Facility and desalination facility costs and Surcharge 2 collections will accrue Allowance for Funds Used During Construction (“AFUDC”) at a rate of the actual costs of funds used to fund the desalination project costs, with adjustments then made depending on certain costs and collections. Once the desalination facilities go into service, California American Water will file a Tier 2 advice letter to put into rates the actual costs along with the net AFUDC accumulated in the expenditure portion of the memorandum account. Likewise, once the CAW-Only facilities are used and useful, California American Water will file a Tier 2 advice letter to put the balance of the memorandum account into rates.

D. Operations & Maintenance (“O&M”) Costs

In the Settlement Agreement, the Parties agree that estimated net O&M costs of \$11.13 million for a 9.6 mgd plant and \$ 9.12 million for a 6.4 mgd plant are reasonable. These figures include power costs, labor costs, chemical costs, membrane and media replacement costs, and repair and replacement costs. In an effort to achieve lower power costs, alternative means of power, including potential power from landfill gas combined with power from Pacific Gas &

¹¹ See p. 5 of Attachment 3 to R. Svindland’s Jan. 11, 2013 Supplemental Testimony.

¹² CA-21, Svindland Rebuttal, pp. 19-20; CA-20, *Rebuttal Testimony of David P. Stephenson*, dated March 8, 2013 (“Stephenson Rebuttal”), pp. 8-10.

Electric Company's ("PG&E's") grid will be studied by an outside consultant retained by California American Water.

For ratemaking purposes, California American Water will update the Commission on O&M costs through a Tier 2 advice letter at least 60 days before the plant is scheduled to enter service. This will be used to set the initial MPWSP revenue requirement. The Commission shall authorize California American Water to establish a MPWSP O&M memorandum account to track the differences between estimated costs adopted through the Tier 2 advice letter process and the actual incurred costs from the beginning of plant operation until the time an estimate of such future costs is filed as part of a future general rate case application. In the first general rate case application after at least one full year of operation of the facilities, California American Water will "true up" the difference between the estimated and actual O&M costs tracked in a memorandum account and seek recovery of all reasonable and prudent differences. Estimates of O&M costs after at least one full year of operation of the plant will be included in the next to be filed general rate case application, and thereon included as part of each succeeding general rate case process.

E. Environmental Factors

Through the Settlement Agreement, the Parties have agreed that as part of the desalination plant's design, California American Water will address beach erosion by (1) selecting, jointly with Surfrider, an expert on the issue who is familiar with the site and its conditions; (2) developing adequate factors for safety based on relevant issues affecting erosion at the site; (3) developing a plan outlining how facilities will be relocated or adapted during the project's lifespan to address beach erosion; (4) considering the use of erosion rate data from the Monterey Bay Sanctuary Foundation Erosion Study; and (5) reviewing certain studies relating to erosion.¹³ California American Water will also provide to the Parties and Governance Committee descriptions of the safety factors, plan, and design criteria incorporating erosion rates.

¹³*Testimony of Bradley Damitz on Behalf of Surfrider Foundation* (Feb. 22, 2013), at pp 2-8.

The Parties further agreed that California American Water will develop and implement an Energy Conservation Plan for the desalination plant to reduce energy consumption and costs along with greenhouse gas emissions. These environmental/mitigation measures are in addition to measures in the MPWSP's Final EIR. To the extent any of the measures in the Settlement Agreement are incompatible with those in the Final EIR, only those in the Final EIR will be pursued.

F. Contingencies

There are three categories of contingencies in the event the MPWSP cannot be implemented as proposed: (1) intake contingencies, (2) discharge contingencies, and (3) siting contingencies. In the Settlement Agreement, the Parties agree the contingency options in Exhibit CA-12, Attachment 9, should be re-ordered to reflect the more recently agreed-upon ordering preference of the Parties for the contingencies. The Settlement Agreement contains the agreed-upon contingency order. Should one of the listed contingencies involve excessive costs, significant environmental impacts, delay, and/or substantial permitting risk, California American Water may consider the next highest-ranked alternative. The Parties reserve the right to support or challenge any contingency before the Commission or other applicable body. If all listed contingencies prove infeasible, California American Water may pursue other options proposed in its application in this proceeding.

G. MPWSP Financing

1. Securitization

Pursuant to the Settlement Agreement, California American Water will, if certain criteria are met, finance a portion of the MPWSP with a tax exempt securitization. The Parties recognize that California American Water will take on material risk with the MPWSP, so it shall have a fixed equity investment of at least 27.0% of the project's total costs.

Moreover, the Parties agree that use of securitization as a component of the MPWSP's financing is reasonable only if it: (1) lowers costs to consumers; (2) does not adversely impact California American Water customers outside of its Monterey County District

by, for example, negatively impacting the Company's credit metrics or rating; (3) does not require a separate California American Water Credit rating; (4) does not alter the Company's current debt-to-equity ratio for the MPWSP portion not financed through securitization; (5) does not alter the Company's currently authorized rate of return; (6) does not materially delay the MPWSP; and (7) does not create a taxable event for California American Water or adverse tax implications for the Company or customers.

The securitization will be for a period of 20 to 30 years and non-recourse to California American Water. The proceeds will be used to finance the MPWSP at the agreed-upon level, reimburse public agency fees and expenses associated with securitization, and reimburse California American Water for fees and expenses associated with the securitization. Securitization will require several steps, including the Company's establishment of a Special Purpose Entity ("SPE"), sale to the SPE of the right to collect a non-bypassable charge from customers in the Company's Monterey County District, authorization by the California Legislature, and a financing order by the Commission. Necessary true-up adjustments of the securitization surcharge will be done through a Tier 1 advice letter. The bonds will be rated by credit rating agencies which will be requested to also affirm the securitization will not negatively impact the credit of California American Water, as a stand-alone entity, or American Water.

If the securitization is not successful, California American Water may recover related reasonably and prudently incurred costs from customers in the Monterey County District. If, at any time, the securitization negatively impacts California American Water, such as in terms of its credit rating, the Company may seek to recover costs associated with that impact from customers in the Monterey County District.

If the public agency cannot obtain a tax-exempt securitization, California American Water will work with it to develop an alternative form of public agency contribution that is consistent with the criteria discussed above, if feasible.

2. Surcharge 2

Total Surcharge 2 collections will be reduced to approximately \$71.5 million to

smooth the transition in rates from the final period under surcharge 2 to the year 1 revenue requirement of the plant. If Surcharge 2 collections fall short of the target, the undercollection will be funded with SRF debt (or company debt if SRF is not available) and equity. California American Water shall treat Surcharge 2 collections as contributions. Surcharge 1 will cease before Surcharge 2 collections begin. This will allow for a more gradual increase of rates directly attributed to the MPWSP.

California American Water will apply the initial \$35 million collected under Surcharge 2 to the CAW-Only Facilities and the remaining \$36.5 million to the desalination plant so long as certain criteria are met. If the MPWSP is stalled for a prolonged period, the Company will cease collecting Surcharge 2 until it has filed a Tier 1 advice letter showing the MPWSP can move forward. If the MPWSP terminates prior to completion, California American Water will file an application with the Commission to return to customers any Surcharge 2 collections over the prudently incurred costs.

3. SRF Financing

SRF financing will, if available, be combined with other methods of financing for the MPWSP. It will be used in proportion to the amount of equity financing necessary to maintain a balanced capital structure, which excludes the amount of securitization bonds (to the extent they are issued). If California American Water cannot obtain SRF funds on its own, it will work with a public agency to secure the funds. If such funds are not available under any circumstances, California American Water, through American Water Capital Corporation, will provide long-term debt financing. For ratemaking purposes, SRF loans will be treated as the Commission has determined in D.05-01-048, and as debt on the Company's financial statement for financial reporting purposes.

H. Ratemaking

The revenue requirement for the rate base portion of the MPWSP will be based on the current and effective cost of capital decision approved by the Commission, and subject to future adjustment as the cost of capital changes. The interest rate on the securitization and SRF

or long-term debt will be set at the time of funding and be recovered in accordance with procedures for that instrument. Property taxes will be included in the revenue requirement. Depreciation rates on all facilities will be determined based on the latest rates filed with the Commission in a GRC proceeding or the annual depreciation adjustment filing made in conjunction with Section 11.21 of the Settlement approved by D.12-06-016 in A.10-07-007. AFUDC shall be allowed on all construction work in progress related to the desalination plant facilities at the actual rate of the instruments used to finance the construction. Income Taxes will be calculated as part of the revenue requirements based on the same procedures and at the same rates as established in the latest authorized GRC decision.

On completion of the desalination facilities, California American Water shall determine the first year revenue requirement for the desalination facilities including the CAW-Only Facilities. At the time California American Water implements the first year revenue requirement for both such facilities, the authorization will supersede any previously established revenue requirement for the CAW-Only Facilities.

The revenue requirement will be placed in rates via the tier 2 Advice Letter process, and will be done so through a separate base rate surcharge in a form aligned with the then current rate design and applied to customers determined to benefit from the facilities.

A new revenue requirement for the base rate surcharge will be established in each subsequent period until the revenue requirement of the plant and CAW-Only Facilities are considered in a subsequent GRC.

I. Governance

In the Settlement Agreement, the Parties have agreed that the Governance Committee Agreement (attached as "Appendix 2"), as modified, provides for consideration of community values and will ensure public agency representation in all the important aspects of the MPWSP. The Parties encourage the Commission to expressly condone, within its decision in this proceeding, California American Water's participation in the Governance Committee consistent with the terms of the Governance Committee Agreement.

IV. THE SETTLEMENT AGREEMENT IS REASONABLE IN LIGHT OF THE WHOLE RECORD, CONSISTENT WITH LAW, AND IN THE PUBLIC INTEREST

Pursuant to Rule 12.1(d), the Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with law, and in the public interest. The Commission has a well-established policy of settling disputes if they are fair and reasonable in light of the whole record.¹⁴ This policy reduces the expense of litigation, conserves scarce Commission resources, and allows parties to “reduce the risk that litigation will produce unacceptable results.”¹⁵ In the *Southern California Gas Co.* decision, the Commission held that the Parties’ evaluation should carry material weight in the Commission’s review of a settlement.¹⁶

The Settlement Agreement in this proceeding should be approved by the Commission because the Agreement is reasonable in light of the entire record, is consistent with the law, and is in the public interest. The very extensive record in this proceeding confirms that the terms of the Settlement Agreement reached by the Parties in this proceeding are just and reasonable.¹⁷ The record includes substantial written testimony and voluminous documentation submitted by the Parties, as well as testimony from weeks of evidentiary hearings that fills 12 volumes and covers more than 2000 transcript pages. It addresses major facets of the MPWSP, including financing, design, cost, environmental, O&M, testing, and location.

With their written and oral testimony submitted, the Parties commenced settlement negotiations. Those discussions spanned several months, necessitating multiple extensions from the Commission. They involved in-person meetings in Monterey and San Francisco, as well as the extensive use of conference calls. They included workshops at the

¹⁴ *Application of Golden State Water Company on Behalf of its Bear Valley Electric Service Division (U913E), for Approval of RPS Contract with BioEnergy Solutions, LLC, and for Authority to Recover the Costs of the Contract in Rates*, Decision 11-06-023, 2011 Cal. PUC LEXIS 330, **17-18.

¹⁵ *Id.*

¹⁶ *Order Instituting Investigation into the operations and practices of the Southern California Gas Company, concerning the accuracy of information supplied to the Commission in connection with its Montebello Gas Storage Facility*, D.00-09-034, 2000 Cal. PUC LEXIS 694, **29, 31.

¹⁷ See, e.g., Direct Testimony of Kevin Thomas (April 23, 2012), at pp. 4-5; Direct Testimony of Richard C. Svindland (April 23, 2012), at pp. 5-6, 8, 37-39.

Commission. And they recognized the importance – indeed necessity – of securing as swiftly as possible an alternative source of water for California American Water’s Monterey County District because of the pending restrictions on diversions from the Carmel River posed by the CDO. Through those lengthy and comprehensive negotiations the Parties, representing the full spectrum of interests and views and most of whom are represented by counsel, addressed a number of complex and difficult issues. The result is a Settlement Agreement that addresses many essential issues in the proceeding. Plant sizing is the subject of a separate agreement.

This Settlement Agreement was accomplished through the tireless work, contribution, and compromise of all Parties to it. Thus, as is discussed in greater detail below, the Settlement Agreement is supported by the record and consistent with the law. Furthermore, it is critical to addressing and providing for the public’s water needs in Monterey, where restrictions on diversions from the Carmel River have been ordered, and are scheduled to be implemented in just a few years. Thus, it is in the public interest.

A. On the Issue of GWR, the Settlement Agreement Is Reasonable, Consistent With the Law, and in the Public Interest

The Settlement Agreement provides for the GWR Project to be considered in a separate phase of the proceeding so information necessary to make a well-informed decision on that Project can be obtained. The Agreement also details the critical findings needed to make the GWR Decision and other issues relating to GWR. The Record contains substantial testimony on the GWR Project.¹⁸ It has been carefully considered by the parties, and on June 12, 2013, a workshop at the Commission took place concerning the GWR Project. The record, therefore, supports the compromise on GWR reflected in the Settlement Agreement. Likewise, the Settlement is consistent with law. It recognizes the need for a Final EIR for the GWR Project and to obtain the necessary permitting for the Project.

Settlement as to the GWR Project is also in the public interest. That Project is a

¹⁸ See e.g., *Testimony of Mike Zimmerman* (Feb. 22, 2013) (“Zimmerman Direct”), at p. 6; *Direct Testimony of Richard C. Svindland* (April 23, 2012), at pp. 5, 28-33; *Direct Testimony of David J. Stoldt* (Feb. 22, 2013), at pp. 11-13, 27-28; *Direct Testimony of Thomas Frutchey* (Feb. 22, 2013), at p. 13.

joint endeavor between two public agencies, MRWPCA and MPWMD, in collaboration with California American Water. The Settlement works to ensure that the GWR Decision is made after critical information can be obtained, thus ensuring the Project's potential inclusion in the MPWSP is adequately considered. This is in the public interest because the GWR Project may provide scheduling advantages in terms of providing much needed source water before the desalination plant comes online. The Project may also foster water supply resilience and reliability because it will diversify the supply of source water. In addition, it may provide other potential advantages, such as reducing carbon emissions and increasing the use of recycled water. Thus, the Settlement Agreement as to GWR is in the public interest and should be adopted.

B. On Issues Concerning the SRGB, the Settlement Agreement Is Reasonable, Consistent With the Law, and in the Public Interest

The Settlement Agreement provides for a cooperative, coordinated approach to assessing and characterizing the potential impact of the MPWSP on the SRGB. Toward that end, the Parties agreed to a joint team that will work with experts designated by Parties to develop a plan and obtain important information through the Hydrogeologic Study. This represents a compromise between the Parties and is intended to avoid litigation regarding the scope and methodology used to obtain information on that potential impact. After carefully considering that information, California American Water will focus its production from a shallow portion of the aquifer and pursue a source water project, to the extent feasible, consistent with it.

The Settlement Agreement reached by the Parties on this issue is just and reasonable in light of the record.¹⁹ There has been extensive testimony on this issue. As a result of that testimony and the cooperation of the Parties, a significant compromise was achieved. The Settlement is also consistent with the law. The Commission requested the SWRCB make recommendations concerning the information necessary to study the impact. In its May 22, 2013

¹⁹ See, e.g., *Direct Testimony of Richard C. Svindland* (April 23, 2012), at pp. 10, 23-25, 28; *Revised Direct Testimony of Lloyd W. Lowrey, JR.* (March 25, 2013), at pp. 7-13, ; WD-5, *Direct Testimony of David J. Stoldt* (Feb. 22, 2013), at pp. 21-27; *Testimony of Timothy Durbin* (Feb. 22, 2013), at pp. 2-5.

Draft Review, the SWRCB did so, and the Settlement Agreement proposes to develop a plan for proposed source water intakes that is consistent with the SWRCB's recommendations.

Consistent with the Monterey County Water Resources Agency Act, the Settlement Agreement acknowledges MCWRA's authority in the SRGB: the Parties agree that a study and report to be undertaken under section 5 of the Settlement Agreement "do not constitute and shall not be taken as any agreement that affects MCWRA's authority with respect to the SRGB." Finally, the Settlement Agreement is in the public interest. It reflects a coordinated effort to conserve resources rather than wasting them on litigation, and it will provide a process and scope for gathering information necessary to ascertain the impact, if any, from the source water project for the MPWSP. The settlement is also in the public interest because it will assist in moving forward with the MPWSP, which is important to address limitations on diversions from the Carmel River imposed by the CDO. Thus, the Settlement Agreement should be adopted.

C. On the Desalination Plant, CAW-Only Facilities, and Contingencies, the Settlement Agreement Is Reasonable, Consistent With the Law, and in the Public Interest

The Settlement Agreement reflects compromise and consensus between the Parties on several critical aspects of the MPWSP. The Parties have reached agreement on the desalination plant as to matters including the use of slant wells, use of a partial second pass reverse osmosis, the intake pipeline, the land purchase, the location, cost estimates, a cost cap, ratemaking, and contingencies. The Settlement Agreement also reflects compromise on important issues relating to the CAW-Only Facilities.

In light of the record, the Settlement Agreement is reasonable as to matters relating to the desalination plant and CAW-Only Facilities.²⁰ Those issues were the subject of extensive written and oral testimony, particularly by DRA and California American Water.²¹ The CAW-Only Facilities were already approved by the Commission in connection with a

²⁰ See, e.g., *Direct Testimony of Richard C. Svindland* (April 23, 2012), at pp. 9-10, 33-34; *Svindland Rebuttal*, pp. 2-6, 8-13, 17-20.

²¹ *Zimmerman Direct*, pp. 3-6; *Direct Testimony of Lloyd W. Lowrey, JR.* (March 25, 2013), at pp. 6-8, 12-16; (Feb. 22, 2013), at pp. 4-14; (Feb. 22, 2013), at pp. 3-9; *Direct Testimony of Alex Wesner* (Feb. 22, 2013), at pp. 2-14; *Revised Prepared Testimony of Ron Weitzman* (Feb. 22, 2013), at pp. 13-15.

previously approved application for a prior proposed project.²² The Settlement Agreement reflects a substantial and reasonable compromise between the Parties. Thus, for example, the cost estimates have been reduced from what was sought in California American Water's Application. DRA has also removed its demand for hard cost caps. After a workshop and negotiations, the Parties also agreed to re-order the list of contingencies.

The Settlement is also consistent with the law. The parties have agreed that a partial second pass reverse osmosis is proper at this phase of the project's design to ensure that the plant continues to meet California Department of Health goals once in operation. The Settlement is also in the public interest because it provides for the expeditious development of a new water supply for California American Water's Monterey County District. The Settlement Agreement, therefore, should be adopted.

D. As to O&M, the Settlement Agreement Is Reasonable, Consistent With the Law, and in the Public Interest

The Settlement Agreement contains a compromise between the Parties concerning O&M, specifically on issues of (1) O&M estimates, (2) efforts to reduce power costs; and (3) the ratemaking process. Issues relating to power costs were the subject of extensive testimony, both written and during the weeks of hearings.²³ DRA heavily scrutinized the cost estimates and models. And California American Water provided testimony in response. Only after such a detailed and critical review did the Parties reach a settlement of these issues which is just and reasonable in light of the record.

The Settlement is consistent with the law. It ensures that updated information will be provided to the Commission and standard practices will be used, including Tier 2 advice letters and California American Water's general rate case application to address ratemaking issues for O&M costs. The Settlement is in the public interest. The costs have been carefully scrutinized, including by DRA. Furthermore, the Settlement seeks to achieve lower electricity rates and ensure a safe and reliable power supply to the plant. Hence, the Settlement Agreement

²² Decision 10-12-016.

²³ See, e.g., *Direct Testimony of Richard C. Svindland* (April 23, 2012), at pp. 25-26; Svindland Rebuttal, pp. 23-24.

should be adopted.

E. On Environmental Factors, the Settlement Agreement Is Reasonable, Consistent With the Law, and in the Public Interest

Through the Settlement Agreement, the Parties have, after extensive negotiations, resolved issues concerning certain environmental factors such as beach erosion as well as the Company's Energy Conservation Plan for energy minimization and greenhouse gas reduction. Substantial evidence was placed in the record on these issues, including by Surfrider and California American Water.²⁴ As part of the Settlement Agreement, the Company agreed to work with Surfrider to jointly select a consultant with specific knowledge of the site and its conditions to address issues concerning the desalination plant and beach erosion. The Company will also develop an adaptive management plan to address issues relation to erosion over the plant's lifetime, and the Company will consider certain surveys and studies cited by Surfrider. The Company will also develop and implement an Energy Conservation Plan in an effort to reduce consumption and greenhouse gasses.²⁵ In light of the record in this case and the diverse interests participating in the lengthy settlement negotiations, the Settlement Agreement is reasonable.

Furthermore, the Settlement Agreement is consistent with the law. It is clear that the measures in the Agreement in no way preclude or preempt any mitigation measures that may be identified in the Final EIR for the MPWSP and adopted by the Commission. Finally, the Settlement Agreement is in the public interest. It resolves important issues relating to beach erosion, and it puts in place procedures for an Energy Conservation Plan, which may result in both cost and greenhouse gas reductions. Thus, the Settlement Agreement should be adopted.

F. On Financing Issues, the Settlement Agreement Is Reasonable, Consistent With the Law, and in the Public Interest

In the Settlement Agreement, the Parties resolve numerous financing-related

²⁴ See, e.g., *Testimony of Bradley Damitz* on Behalf of Surfrider Foundation (Feb. 22, 2013), at pp. 2-10; *Direct Testimony of Richard C. Svindland* (April 23, 2012), at pp. 26-27; *Svindland Rebuttal*, pp. 2-4, 7.

²⁵ *Direct Testimony of Kevin Thomas* (April 23, 2012), at pp. 6-7; *Direct Testimony of Richard C. Svindland* (April 23, 2012), at p. 35.

issues for the MPWSP, including those for (1) securitization, (2) Surcharge 2, and (3) SRF Financing. The Parties have agreed that, if certain criteria are met, securitization will be used to finance a portion of the MPWSP. This will potentially result in a more favorable interest rate. It will also reduce California American Water's equity interest in the project to a minimum of 27%. The Parties have agreed to a reduced figure for Surcharge 2 collection, to treat Surcharge 2 collections as contributions, to provisions governing how Surcharge 2 collections will be handled in certain contingencies, and to how the funds will be used and tracked. As to SRF financing, the Parties reaffirmed it remains the preferred option for debt financing a portion of the MPWSP. They also recognized that if California American Water cannot obtain SRF on its own, it will partner with a public entity, and they addressed how SRF debt will be treated for ratemaking, and what will be done if such SRF financing cannot be obtained.

The record contains extensive testimony and exhibits concerning these financing related issues.²⁶ Outside consultants were brought in to provide testimony on several of the issues, and many days of the hearings focused on financing issues. Lengthy discussions between the Parties followed, and, among other things, California American Water ultimately agreed to a reduced equity share in the MPWSP provided certain criteria are met. California American Water also agreed to partner with a public agency if that is necessary to obtain SRF financing. In light of the record, therefore, the Settlement Agreement on financing issues is reasonable. It is also consistent with the law. The record contains ample testimony that securitization has previously been used and the Settlement requires that procedures for obtaining securitization, such as securing legislation, would be used. Finally, the Settlement Agreement is in the public interest. It resolves financing issues in a manner that, through the possible use of securitization and SRF, reduces the cost of borrowing and thereby benefit customers. It also addresses issues concerning Surcharge 2, which will help to lower interest costs and more gradually phase in rate increases. Thus, the Settlement Agreement should be adopted.

²⁶ See, e.g., *Direct Testimony of Richard C. Svindland* (April 23, 2012), at p. 35; *Svindland Rebuttal*, p. 22; *Rebuttal Testimony of William Rogers* (April 1, 2013 ErrataVersion), at pp. 3-9; *Rebuttal Testimony of William J. Chambers* (March 8, 2013), at pp. 7-16. .

G. On Issue of Ratemaking, the Settlement Agreement Is Reasonable, Consistent With the Law, and in the Public Interest

After extensive testimony and negotiations, the Parties settled issues relating to ratemaking for several aspects of the MPWSP and the matters resolved above, such as when interest rates on securitization and SRF will be set, the use of AFUDC, calculation of income taxes as part of the revenue requirement, determination of depreciation rates, and other concerns. The settlement has been reached by parties representing diverse interests, including ratepayers, environmental groups, business groups, local government governments and government agencies, as well as other key stakeholders on the Monterey Peninsula. It is based on a careful consideration of the matters in the proceeding. It is thus reasonable in light of the record. The Settlement is also consistent with the law. It permits recovery through well established mechanisms. Finally, it is in the public interest. It sets out the perimeters for the recovery in rates of costs associates with the MPWSP. That project is needed to provide a much needed source of water to California American Water's Monterey County District, especially in light of pending restrictions on diversion of water from current sources. Thus, it is in the public interest. The Settlement Agreement, therefore, should be adopted.

V. CONCLUSION

The Parties respectfully request that the Commission adopt and approve the Settlement Agreement and grant California American Water a CPCN authorizing it to construct the MPWSP, which will include a desalination plant and the CAW-Only Facilities.

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Attachment A

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Application of California-American Water Company (U210W) for Approval of the Monterey Peninsula Water Supply Project and Authorization to Recover All Present and Future Costs in Rates.

A.12-04-019
(Filed April 23, 2012)

**SETTLEMENT AGREEMENT OF
CALIFORNIA-AMERICAN WATER COMPANY, CITIZENS FOR PUBLIC WATER,
CITY OF PACIFIC GROVE, COALITION OF PENINSULA BUSINESSES, COUNTY
OF MONTEREY, DIVISION OF RATEPAYER ADVOCATES, LANDWATCH
MONTEREY COUNTY, MONTEREY COUNTY FARM BUREAU, MONTEREY
COUNTY WATER RESOURCES AGENCY, MONTEREY PENINSULA REGIONAL
WATER AUTHORITY, MONTEREY PENINSULA WATER MANAGEMENT
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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Application of California-American Water Company (U210W) for Approval of the Monterey Peninsula Water Supply Project and Authorization to Recover All Present and Future Costs in Rates.

A.12-04-019
(Filed April 23, 2012)

**SETTLEMENT AGREEMENT OF
CALIFORNIA-AMERICAN WATER COMPANY, CITIZENS FOR PUBLIC WATER,
CITY OF PACIFIC GROVE, COALITION OF PENINSULA BUSINESSES, COUNTY
OF MONTEREY, DIVISION OF RATEPAYER ADVOCATES, LANDWATCH
MONTEREY COUNTY, MONTEREY COUNTY FARM BUREAU, MONTEREY
COUNTY WATER RESOURCES AGENCY, MONTEREY PENINSULA REGIONAL
WATER AUTHORITY, MONTEREY PENINSULA WATER MANAGEMENT
DISTRICT, MONTEREY REGIONAL WATER POLLUTION CONTROL AGENCY,
PLANNING AND CONSERVATION LEAGUE FOUNDATION, SALINAS VALLEY
WATER COALITION, SIERRA CLUB, AND SURFRIDER FOUNDATION**

1. GENERAL

1.1 Pursuant to Article 12 of the Rules of Practice and Procedure of the California Public Utilities Commission (“Commission”), California-American Water Company (“California American Water”), Citizens for Public Water (“CPW”), City of Pacific Grove, Coalition of Peninsula Businesses, County of Monterey (the “County”), Division of Ratepayer Advocates (“DRA”), LandWatch Monterey County (“LandWatch”), Monterey County Farm Bureau (“MCFB”), Monterey County Water Resources Agency (“MCWRA”), Monterey Peninsula Regional Water Authority (“MPRWA”), Monterey Peninsula Water Management District (“MPWMD”), Monterey Regional Water Pollution Control Agency (“MRWPCA”), Planning and Conservation League Foundation, Salinas Valley Water Coalition (“SVWC”), Sierra Club, and Surfrider Foundation (“Surfrider”) (collectively, “the Parties”), to avoid the expense and uncertainty of litigation of the matters in dispute between them before the Commission, agree on the terms of this Settlement Agreement, which they now submit for review, consideration, and approval by the Commission.

1.2 On April 23, 2012, California American Water filed an application for a Certificate of Public Convenience and Necessity (“CPCN”) for the Monterey Peninsula Water Supply Project (“MPWSP”) and Authorization to Recover All Present and Future Costs in Rates (“Application”). The purpose of the MPWSP is to replace a significant portion of the existing water supply from the Carmel River, as directed by the State Water Resources Control Board

("SWRCB"). (SWRCB Order Nos. WR 95-10 (July 6, 1995) and; WR 2009-0060 (Oct. 20, 2009).) The MPWSP requires two elements: (1) a desalination plant and related facilities, and (2) what are commonly referred to as the "CAW-Only Facilities."

(a) The desalination plant and related facilities will consist of slant intake wells, brackish water pipelines, the desalination plant, product water pipelines, brine disposal facilities, and related appurtenant facilities. The slant wells will be approximately 700 to 800 feet in length and will feature several hundred feet of screen below the ocean floor. The final layout and configuration will be based on the results of the groundwater modeling and technical analysis.

(b) The CAW-Only Facilities are the same undertaking the Commission previously approved in D.10-12-016 and will consist of the Transfer Pipeline, the Seaside Pipeline, the Monterey Pipeline, the Terminal Reservoir, the Aquifer Storage and Recovery ("ASR") Pipeline, the ASR Recirculation and Backflush Pipelines, the ASR Pump Station and the Valley Greens Pump Station. The current configuration of the Monterey County District's distribution system does not allow water to be conveyed from the north to customers on the southern portion of the Peninsula. All reasonably foreseeable replacement water supply solutions to satisfy the requirements of SWRB WR 2009-0060 will require water to be conveyed from the north to southern portions of the Peninsula. The CAW-Only Facilities will convey water between the northern and southern portions of the Monterey County District. The Facilities will supply water from the desalination plant portion of the MPWSP (or other reasonably foreseeable alternative) and/or the extraction of flows from the ASR system located in Seaside Basin, which will enter California American Water's distribution system at the metering station from the north.

1.3 In its application, California American Water sought authorization to initially size the desalination plant portion of the MPWSP at 9.0 million gallons per day ("mgd"). California American Water also requested authorization to reduce the size of the desalination plant component of the MPWSP to 5.4 mgd and supplement water supplies through a water purchase agreement ("WPA") to purchase water from the separate Groundwater Replenishment Project ("GWR Project"), if the GWR Project reaches certain milestones by the time California American Water is ready to construct the MPWSP's desalination plant, and the cost of GWR Project water is reasonable. (Application, pp. 1, 5-6.) California American Water subsequently updated its proposed sizes for the desalination plant to 9.6 mgd without the GWR Project and 6.4 mgd with the GWR Project. (CA-12, *Supplemental Testimony of Richard C. Svindland*, dated January 11, 2013 ("Exhibit CA-12"), p. 5.) The Settlement Agreement does not resolve the issue of the appropriate sizing of the desalination plant. California American Water has entered into a separate settlement agreement regarding the proposed size of the desalination plant.

1.4 The GWR Project is a separate project from the MPWSP. It is a joint project between MRWPCA and MPWMD. The GWR Project will create a source of supply by filtering source water through a new advanced water treatment facility, and injecting the highly treated product replenishment water into the Seaside Basin Aquifer, where it would be diluted and stored. California American Water has entered into a Memorandum of Understanding with MRWPCA and MPWMD to collaborate on developing the GWR Project. The Parties have agreed upon a process for determining whether the GWR Project has met the milestones

necessary to reduce the size of the desalination plant component of the MPWSP. That process is discussed below in Section 4.

1.5 In a separate process from this proceeding, the local agencies affected by the MPWSP are addressing certain issues related to the allocation of water obtained from the MPWSP.

(a) MPWMD has begun the process of updating its existing Environmental Impact Report (“EIR”) to address the environmental impacts pertaining to the allocation of water from the MPWSP.

(b) MPWMD will initiate a process and collaborate with MPRWA, the County, and California American Water to develop proposed amendments to MPWMD’s water allocation ordinances to address the allocation of water obtained from the MPWSP, and thereafter agendize the proposed amendments for consideration by MPWMD.

(c) MPWMD will initiate a process and collaborate with MPRWA, the County, and California American Water to develop a process to determine an accurate estimate of the added capacity necessary to meet the General Plan build out projections for the communities served by California American Water. The findings from this process shall be reported to the Commission either within a subsequent rate design phase of A.12-04-019 or as part of the general rate case process.

1.6 In an effort to work together to avoid future water supply shortages, California American Water will initiate a process and collaborate with MPWMD, County, and MPRWA to develop a process to determine a reasonable “trigger” for further review of the adequacy of the California American Water supply to avoid future water supply shortage conditions arising from either increased demand or decreased supply. The findings from this process shall be reported to the Commission either within a subsequent rate design phase of A.12-04-019 or as part of the general rate case process.

1.7 California American Water proposed a connection fee for its Monterey main system in its 2013 general rate case. That fee is intended to equitably spread some of the MPWSP costs to future connections and reduce costs to existing customers. California American Water’s proposed connection fee shall be used to reduce MPWSP costs and not as revenue for any public agency, including MPWMD, MPRWA, and/or the County.

2. PROCEDURAL HISTORY

2.1 California American Water filed its application for a CPCN for the MPWSP on April 23, 2012.

2.2 Workshops on MPWSP costs, contingencies, and financial modeling were held on December 11-13, 2012.

2.3 California American Water served supplemental testimony on January 11, 2013. DRA and intervenors served testimony on February 22, 2013. California American Water served rebuttal testimony on March 8, 2013.

2.4 Evidentiary hearings were held on April 2-11, 2013 and April 30-May 2, 2013.

2.5 Notice of an all-party settlement meeting was served by MPRWA on April 18, 2013. The all-party settlement meeting was held on April 30, 2013 at the Commission. Settlement discussions continued through May, June, and July 2013.

3. SUPPORT FOR A WATER SUPPLY PORTFOLIO

3.1 The Parties believe that the development, construction, and operation of the MPWSP, combined with the GWR Project if certain findings are made pursuant to Section 4 below, and the use of ASR, serve the public convenience and necessity consistent with the criteria set forth in Public Utilities Code Section 1002(a). The Parties support the granting of a CPCN for the MPWSP, subject to the Commission's review of the project under the California Environmental Quality Act ("CEQA") and the findings required under Public Resources Code Section 21081, and subject to the Commission's resolution of the desalination plant sizing.

(a) Surfrider supports the granting of a CPCN contingent upon a reasonable resolution of brine discharge for the MPWSP, which, in Surfrider's opinion, must include the use of dedicated, pressurized brine diffusers.

(b) SVWC, MCFB, LandWatch, and CPW support the granting of a CPCN contingent upon a resolution of the source water issues relating to the Salinas River Groundwater Basin ("SRGB"), which will be informed by the Hydrogeologic Study and the Technical Report described in Section 5 of this Settlement Agreement. SVWC, MCFB, LandWatch, and CPW are concerned about potential harm to the SRGB and the users of groundwater thereof resulting from California American Water's production of source water for the MPWSP. The SVWC, MCFB, MCWRA, and CPW believe that pumping of California American Water's source wells within a shallow portion of the aquifer system, sometimes referred to as the Sand Dunes Aquifer, will avoid potential harm to the SRGB and users thereof, but knowledge of whether pumping from the Sand Dunes Aquifer will avoid potential harm will be addressed in the Hydrogeologic Study, the Technical Report, and the Commission's EIR. SVWC, MCFB, LandWatch, and CPW are concerned that California American Water's pumping of source water wells from an aquifer system beneath an aquitard that may be present at the location of the proposed source water wells, sometimes referred to as the 180 foot aquifer, could result in potential harm to the SRGB and users thereof. The Parties agree that the Hydrogeologic Study and the Technical Report described in Section 5 of this Settlement Agreement do not constitute and shall not be taken as any agreement that affects MCWRA's authority with respect to the SRGB. In light of all the foregoing, SVWC, MCFB, MCWRA, LandWatch, and CPW reserve all rights to challenge production of water from the SRGB and/or the Sand Dunes Aquifer by California American Water in any appropriate forum.

3.2 The Parties to this Settlement Agreement agree that time is of the essence in implementing the MPWSP.

4. GROUNDWATER REPLENISHMENT PROJECT

4.1 Separate Phasing of Groundwater Replenishment Project

(a) The Parties agree that the Commission shall decide whether to authorize California American Water to build, as part of the MPWSP, a smaller desalination plant to accommodate the WPA for the product water of the separate GWR Project or, alternatively, build a larger desalination plant without a WPA for the GWR product water (the “GWR Decision”), based on findings related to schedule, cost, benefits, and feasibility. The parties agree that the decision whether these findings are or will be made requires additional information that is currently not available, including more detailed information regarding the schedules and designs of the GWR Project and MPWSP desalination plant, as well as agreements for source and product water for the GWR Project. Accordingly, the parties agree that the GWR Decision should be made in a separate phase of this proceeding after the parties have developed necessary information.

(b) The Parties have developed and set forth in this section certain criteria for consideration by the Commission to facilitate its adopting findings necessary to making the GWR Decision after evidentiary hearings in this separate phase.

(c) The Parties agree to file and support a Motion for Bifurcation of the GWR Decision into a separate phase. Such motion will:

(i) Identify GWR Decision criteria to be addressed in the separate phase as outlined in Section 4.2 below;

(ii) Seek such additional amendments in the scope of this proceeding as may be necessary; and

(iii) Present an agreed-upon procedural schedule and scope as identified in Section 4.3 below, including the possibility that an advice letter process may be used to demonstrate fulfillment of some criteria after the Commission decision in the bifurcated phase.

4.2 Findings for GWR Decision

(a) After careful consideration and negotiations, the Parties agree the Commission should make the GWR Decision based upon the findings set forth below and/or information supplied pursuant to the advice letter process in Section 4.3(f). If all of the findings are made or addressed through the advice letter process, then California American Water shall be ordered to enter into a WPA and build the smaller desalination plant. If they are not made or addressed through the advice letter process, then California American Water shall proceed with the larger desalination plant. On that basis, the Parties recommend that the Commission’s primary focus be on the findings set forth below in the separate phase where it makes the GWR Decision. The findings are as follows:

(i) MRWPCA has approved the GWR Project pursuant to a certified Final EIR; and no CEQA suit has been filed within 30 days of a Notice of Determination ("NOD"), or if a CEQA suit is filed, no stay of the GWR Project has been granted;

(ii) The status of required permits is consistent with the published project schedule, and for any required permits not yet obtained, the weight of the evidence in the record does not show that any of the required permits for the GWR Project are unlikely to be obtained in a timeframe consistent the published project schedule;

(iii) There is sufficient legal certainty as to agreements or other determinations in place to secure delivery of source water(s) necessary to produce between 3,000 to 3,500 acre feet per year of GWR product water for the recommended project.¹

(1) The parties acknowledge that MCWRA and MRWPCA are the parties to that certain Agreement Between The Monterey County Water Resources Agency and the Monterey Regional Water Pollution Control Agency For Construction and Operation of a Tertiary Treatment System dated June 16, 1992, as amended by Amendment No. 1 on May 30, 1995, Amendment No. 2 on February 16, 1998, and Amendment No. 3 executed by MRWPCA on May 10, 2002 and MCWRA on May 29, 2002 (all collectively hereinafter referred to as "Tertiary Treatment Agreement") and that MCWRA and MRWPCA disagree as to the amounts of "tertiary treated water," as that term is defined in Section 2 of aforementioned Amendment No. 3 to the Tertiary Treatment Agreement, to which each is entitled under the Tertiary Treatment Agreement. With respect to the availability of such tertiary treated water from the Tertiary Treatment Agreement for the GWR Project in an amount that would support a Commission finding of sufficient legal certainty, such availability shall be determined pursuant to the dispute resolution provisions in the Tertiary Treatment Agreement and shall not be determined through action by this Commission. Therefore, the parties agree that with respect to any product water(s) to be conveyed by MRWPCA to implement the GWR Project that are provided pursuant to rights to such tertiary treated water under the Tertiary Treatment Agreement, for the purposes of this Settlement Agreement, no Party shall request either the Commission or the Governance Committee to interpret, rule on, or provide any opinion as to contract rights under the Tertiary Treatment Agreement, and further agree that neither the Commission nor the Governance Committee should so interpret, rule on, or provide any opinion as to any such contract rights;

(iv) The weight of the evidence in the record does not show that the California Department of Health or the Regional Water Quality Control Board will decline to accept or approve the GWR extraction or GWR treatment and injection processes, respectively;

¹The Parties recognize that based upon the expected number of trains needed for the desalination plant, the desalination plant could be optimally sized to accommodate certain discrete capacities of 3,000 or 3,500 acre feet per year of GWR product water in order to produce a certain combined capacity from the desalination plant and the GWR Project. California American Water and MRWPCA recognize that cost optimization may not occur at certain discrete capacities for the GWR Project and desalination plant based on the configuration, size and number of the trains. Certain parties have entered into a settlement agreement regarding the sizing of the desalination facilities for purposes of planning and engineering, which provides for the possible combined capacity of the desalination plant and the GWR Project.

(v) The GWR Project is on schedule, as verified by a report issued by an engineer licensed in California, to be operable,² on or before the later of (a) the then-effective date of the Cease and Desist Order of the SWRCB or such other date as the SWRCB states in writing is acceptable, or (b) the date the MPWSP desalination project is scheduled to become operable. The Parties acknowledge that the actual date of operation for the GWR Project and the desalination project could vary from the operation date projected in the schedules, and therefore agree to a range of up to an additional four months from the projected date of operation, before the GWR Project schedule would no longer be considered on an acceptable schedule;

(vi) Preliminary design for the GWR Project is at least at the 10% level, represented by a basis of design report (so that an accurate project cost estimate can be generated) or is at a level similar to or more advanced than the level of design for the desalination project portion of the MPWSP;

(vii) A GWR Project funding plan, sufficient in detail to be accepted as an application for a State Revolving Fund loan, is in place;

(viii) California American Water, MPWMD, and MRWPCA have agreed on a WPA whose terms are just and reasonable; and

(ix) The revenue requirement for the combination of the GWR Project and the smaller desalination project, including the projected debt equivalence for the GWR Project, if any, determined pursuant to Section 4.4, is just and reasonable when compared to the revenue requirement for a larger desalination project alone.

(b) The parties agree that a revenue requirement premium for the combination of the GWR Project and a smaller MPWSP desalination project may be determined just and reasonable, for some, but not necessarily all of the following reasons, if the combined GWR/smaller desalination project affords significant net benefits in comparison to a larger desalination project alone upon a consideration of all positive and negative externalities associated with the GWR Project. Significant positive benefits that could support the Commission's approval of such a premium, include, but are not limited to, the following: (i) a material schedule advantage in that the GWR Project is anticipated to be operable sooner than the desalination plant; (ii) water supply resilience and reliability (benefit of the portfolio approach); and (iii) other positive externalities of the GWR Project, including, but not limited to reduced atmospheric carbon emissions, reduced brine discharge, and the implementation and encouragement of State policies regarding water recycling through early adoption of a water reuse project. The Parties anticipate that the evidentiary hearings in the separate phase will support findings by the Commission of an upper range of reasonableness for the price of GWR Project water for inclusion in the WPA based upon consideration of all positive and negative externalities associated with the GWR Project.

²The operable date of the GWR Project is the date when extractions may first be made by California American Water from the Seaside Groundwater Basin as the result of the injection and storage of GWR Project recycled water.

4.3 Procedural Schedule and Scope

(a) The Parties agree to file a Motion to Bifurcate or Otherwise Resolve GWR Decision consistent with this Settlement Agreement promptly after the filing of this Settlement Agreement. The bifurcated schedule is intended to allow determination of the GWR Decision by the Commission prior to the time when California American Water is at the necessary decision point relative to the sizing of the desalination facilities.

(b) The Parties agree to request, as part of the aforementioned motion, that the Commission establish the following procedural schedule, designed to achieve a timely determination of the GWR Decision:

- (i) Testimony of Interested Parties – December 2014
- (ii) Settlement – commencing in January 2015
- (iii) Concurrent Rebuttal Testimony – January 2015
- (iv) Evidentiary Hearings – February 2015
- (v) Briefing – March 2015
- (vi) Proposed Decision – June 2015
- (vii) Final Decision – July 2015

(c) The Parties acknowledge that this schedule is intended to provide time for the following:

- (i) finalization of source water agreements and determinations;
- (ii) refinement of the design of the GWR and MPWSP desalination projects to support accurate cost comparisons;
- (iii) agreement on the form and terms of a WPA, as evidenced by an executed agreement between the parties to the WPA;
- (iv) assessment of the benefits of the GWR Project that may reflect a revenue requirement premium that is just and reasonable;
- (v) estimation of the revenue requirement adjustment, if any, the Commission determines necessary for the WPA pursuant to Section 4.4; and
- (vi) completion of other GWR Project milestones prior to testimony and hearings.

(d) The Parties agree that: (i) the Governance Committee, as described in Appendix 1 to this Agreement, is comprised of representatives of local public agencies that are directly accountable to the public that will be served with water from the MPWSP; (ii) that

the Governance Committee provides an appropriate means for expression of community preferences concerning the MPWSP; (iii) the GWR Decision will impact the size of the MPWSP desalination plant; and (iv) for this reason, the Governance Committee's opinion on any one or more of the findings for the GWR Decision set forth above should be provided to the Commission for the Commission's consideration. Therefore, should the Governance Committee issue a written statement concerning any one or more of the findings set forth above on or before the date set forth above in Paragraph 4.3(b) for submission of testimony or evidentiary hearings, California American Water shall file said written statement with the Commission within ten days of receipt for the Commission's consideration.

(e) The Parties agree that the Commission should be able to adopt findings supporting its GWR Decision at the end of the GWR Decision Phase outlined above, but acknowledge that certain necessary actions may not have occurred by that time. With respect to those actions, the Parties agree that the Commission may direct California American Water to file an advice letter with the Commission demonstrating that the remaining actions have occurred. Issues which may be resolved by advice letter could include, but are not limited to, MRWPCA's approval of the GWR Project.

4.4 Debt Equivalence for the GWR Project

(a) The Parties acknowledge that a WPA is a contractual obligation of a significant amount of California American Water's future cash flows. If the obligation must be capitalized by, and is an obligation of, California American Water under Generally Accepted Accounting Principles (GAAP) standards then in effect, it would have a significant impact on the amount of debt and capital assets California American Water records on its financials and could potentially adversely impact California American Water's debt ratios. If it is not required to be capitalized, the rating agencies could nonetheless impute debt for the WPA, which could have a negative impact on the credit rating of California American Water as a stand-alone entity. The Parties therefore agree that the Commission shall determine whether adjustments to the California American Water revenue requirement for the Monterey County District are required to address the debt equivalence impact resulting from the WPA for the GWR Project or for the capitalized obligation of the WPA in a separate phase of this proceeding before the Commission (as described in Section 4.3). California American Water shall consider in good faith any reasonable terms and conditions of a WPA advanced by the public agencies intended to address the debt equivalence issue for the GWR Project.

5. HYDROGEOLOGIC STUDY

5.1 California American Water's hydrologist and technical team will work with SVWC's hydrologist and technical team, and other technical experts designated by California American Water and the SVWC (collectively, the "Technical Group"), to develop a written work plan for the proposed source water intake sites consistent with the study recommendations presented in SWRCB's May 22, 2013 Draft Review of the MPWSP. The primary purpose of the work plan is to reach agreement among the Technical Group about the studies, well tests, field work, modeling, monitoring, and other data analyses most appropriate to assess and characterize whether and to what extent the proposed operation of the MPWSP may adversely affect the SRGB and the water supply available to legal water users thereof ("Hydrogeologic Study"). The

Parties agree that the purpose of this Section 5 is intended to avoid litigation regarding the scope of and methodology used to develop the Hydrogeologic Study and the Technical Report. California American Water will implement and carry out the Hydrogeologic Study as soon as feasible, taking into account, without limitation, the time involved in obtaining or acting on required permits and the complexity of the analyses involved. Changes to the work plan, in response to logistical constraints, shall be presented to the Technical Group for review and comment. California American Water understands that time is of the essence.

5.2 Upon completion of the Hydrogeologic Study, and as necessary and appropriate while the Hydrogeologic Study is conducted, the Technical Group will review and evaluate the data and results of the Hydrogeologic Study, and will prepare a Technical Report presenting the findings and conclusions of the Technical Group. The Technical Group shall work to resolve any disagreements amongst its members as to the findings and conclusions from the Hydrogeologic Study, but consensus shall not be required to produce the Technical Report. Where consensus cannot be achieved concerning a particular finding or conclusion, the Technical Report shall reflect all of the opinions of the Technical Group, including minority opinion(s) on those topics where consensus could not be achieved. At the option of California American Water and/or SVWC, dissent opinions on conclusions may be further evaluated by an impartial third-party expert.

5.3 After careful consideration of the findings and conclusions set forth in the Technical Report, California American Water, in consultation with the Technical Group and other necessary or appropriate agencies, shall focus its production from a shallow portion of the aquifer system, sometimes referred to as the Sand Dunes Aquifer, and pursue a source water project and program for the MPWSP, to the extent feasible, that is most consistent with the Technical Report and the recommendations of the Technical Group. Consistent with the foregoing sentence and to the extent feasible, California American Water will pursue source water development, for the MPWSP in the shallow portion of the aquifer system. As used in this paragraph, whether a source water project or program is feasible shall be determined by California American Water.

5.4 California American Water will make an information compliance filing, which will be provided to the service list for A.12-04-019, that presents the results from the Hydrogeologic Study and Technical Report.

6. DESALINATION PLANT

6.1 Slant Wells

(a) The Parties agree that it is reasonable for California American Water to use subsurface intake via slant wells for the desalination plant, subject to confirmation of the feasibility of this option by the test well results and hydrogeologic studies.

6.2 Partial Second Pass Reverse Osmosis

(a) The Parties agree that it is reasonable to plan for a partial second pass on the reverse osmosis system because a single pass reverse osmosis system can likely barely achieve the current California Department of Public Health goal in terms of boron rejection.

Over time, as membrane performance wanes, it will not be possible to meet the state's boron goal. (CA-21, Svindland Rebuttal, p. 10; CA-19, *Rebuttal Testimony of Eric J. Sabolsice*, dated March 8, 2013, pp. 6-7.)

6.3 Intake Pipeline

(a) The Parties agree that it is reasonable to plan to use a high-density polyethylene (HDPE) pipe with an inner diameter of 36 inches for the intake pipeline. (CA-21, Svindland Rebuttal, pp. 12-13.)

6.4 Land Purchase

(a) The Parties agree that California American Water's purchase of the 46-acre parcel on Charles Benson Road for the desalination plant is reasonable. (CA-21, Svindland Rebuttal, p. 9; PW-1, *Direct Testimony of George T. Riley for Citizens For Public Water*, dated February 21, 2013, pp. 7-8.)

6.5 Location

(a) The Parties agree that the proposed location of the desalination plant north of Marina is reasonable because (1) the geology for the slant wells at the proposed site is promising, (2) it is close to MRWPCA's existing outfall, which provides for an efficient way to dispose of brine discharge, and (3) it is next to a landfill, which provides additional power options. (CA-21, Svindland Rebuttal, p. 9.) Based on input from several state and federal agencies, California American Water has moved the proposed location of the slant test well and potentially the full production well field to within the active mining area of Cemex's Lapis Road facility. The proposed well field will be located to reduce environmental impacts and is proposed to be located south of the dredge pond within the active mining area.

6.6 Cost Estimates

(a) The Parties considered updated cost estimates with a range for both the 6.4 and 9.6 mgd plant options. (See p. 5 of Attachment 3 to R. Svindland's Jan. 11, 2013 Supplemental Testimony.) Those ranges are from a low of \$152 million to a high of \$223.5 million for the 6.4 mgd option and from a low of \$188.9 million to a high of \$277.8 million for the 9.6 mgd option. Through this Settlement, the Parties agree to cost estimates of \$210.6 million for the 6.4 mgd option and \$253.4 million for the 9.6 mgd option. The agreed-upon cost estimates address issues raised by various parties and include compromises made in order to reach agreement for the purpose of this Settlement. The cost estimates are intended to include variations in the project costs resulting from certain items, including intake contingencies, discharge contingencies, and site contingencies, set forth in Section 10. When taken as a whole, and based on the currently available information, these estimates provide a reasonable basis for the Commission to reach a decision. The cost estimates are for budgeting purposes, and California American Water will only place its actual costs in rates.

6.7 Cost Cap

(a) The Parties agree that for purposes of setting a cost cap for the desalination facilities, \$210.62 million for the 6.4 mgd option and \$253.36 million for the 9.6 mgd option, shall be used. These cost caps include a budget of \$31.83 million for potential implementation of a brine diffuser, an additional pipeline to Potrero Road³ in the event that source water outside of California American Water's proposed site for slant intake wells is proven to be necessary, and other contingencies set forth in Section 10.⁴

(b) The cost caps are not absolute. If California American Water's costs exceed the estimated cost caps set forth above, (but are less than \$223.5 million for the 6.4 mgd option and \$277.8 million for the 9.6 mgd option),⁵ it may seek recovery for reasonable and prudent costs above the caps by filing a Tier 2 advice letter. If California American Water's costs exceed \$223.5 million for the 6.4 mgd option and \$277.8 million for the 9.6 mgd option, it will file a petition for modification with the Commission for recovery. (CA-21, Svindland Rebuttal, pp. 19-20; CA-20, *Rebuttal Testimony of David P. Stephenson*, dated March 8, 2013 ("Stephenson Rebuttal"), pp. 8-10.)

(c) Cost overruns which cause California American Water to exceed the cost cap for the desalination facilities shall be counted against the cost cap for the CAW-Only Facilities set forth in Section 7.2, so long as California American Water has not exceeded the aggregate of the cost cap amounts for the desalination facilities and the CAW-Only Facilities. Conversely, cost savings which California American Water achieves relative to the cost cap for the desalination facilities shall be counted towards the cost cap for the CAW-Only Facilities, so long as California American Water has not exceeded the aggregate of the cost cap amounts for the desalination facilities and the CAW-Only Facilities.

6.8 Ratemaking Process

(a) California American Water will establish a memorandum account to track the costs for the desalination facilities and CAW-Only Facilities, as well as to accumulate Surcharge 2 funds in excess of the \$35.1 million that will first be credited against spending on the CAW-Only Facilities as noted later in Section 7.3. The cost of the desalination facilities and the Surcharge 2 collections will be tracked separately in the memorandum account.

(b) The net of the desalination facility costs and Surcharge 2 collections will accrue Allowance for Funds Used During Construction ("AFUDC") at a rate of the actual cost of funds used to fund the desalination project costs. The rate shall be adjusted quarterly

³ The contingency contemplates a series of slant wells launched ocean ward from the State Park parking lot, located at the western end of Potrero Road, and a pipeline which would run from Charles Benson Road to Potrero Road.

⁴ If the desalination plant is sized at 6.9 mgd to accommodate 3,000 AFY of GWR product water, the Parties agree that a cost cap for the desalination facilities of \$214.08 million (for a combined cost cap of \$299.12 million for the desalination facilities and the CAW-Only Facilities) shall be used.

⁵ If the desalination plant is sized at 6.9 mgd to accommodate 3,000 AFY of GWR product water, the Parties agree that if California American Water's costs exceed the estimated cost cap for the desalination facilities of \$214.08 million but less than \$227.81 million (or \$334.69 million for the combined desalination facilities and the CAW-Only Facilities), it may seek recovery for reasonable and prudent costs above the cap by filing a Tier 2 advice letter.

to reflect the latest funding costs and will be added into the desalination facility portion of the memorandum account if the total accumulations in the expenditure portion of the memorandum account exceeds the Surcharge 2 collection portion of the memorandum account, or the AFUDC will be added to the Surcharge 2 collection part of the memorandum account if the Surcharge 2 collection portion of the memorandum account exceeds the accumulation in the expenditure portion of the memorandum account.

(c) Once the desalination facilities go into service, California American Water will file a Tier 2 advice letter to put the actual costs, along with the net AFUDC accumulated in the expenditure portion of the memorandum account, into rates.

7. CAW-ONLY FACILITIES

7.1 Cost Estimate

(a) The Parties agree to an \$85.04 million cost estimate for the CAW-Only Facilities. This estimate addresses issues raised by various parties, and includes compromises made in order to reach agreement for the purpose of this Settlement. Thus, there is a reasonable basis for the Commission to reach a decision. The cost estimate is for budgeting purposes, and California American Water will only place its actual costs in rates.

7.2 Cost Cap

(a) Based on the cost estimate above, the Parties agree to a cost cap for the CAW-Only Facilities of \$85.04 million.

(b) The cost cap is not absolute. If the costs for the CAW-Only Facilities exceed \$85.04 million (but are less than \$106.875 million), California American Water may seek recovery for reasonable and prudent costs above the cap by filing a Tier 2 advice letter. If California American Water's costs exceed \$106.875 million, it will file a petition for modification with the Commission for recovery of any portion exceeding \$106.875 million.

(c) Cost overruns which cause California American Water to exceed the cost cap for the CAW-Only Facilities shall be counted against the cost cap for the desalination facilities set forth in Section 6.7, so long as California American Water has not exceeded the aggregate of the cost cap amounts for the desalination facilities and the CAW-Only Facilities. Conversely, cost savings which California American Water achieves relative to the cost cap for the CAW-Only Facilities shall be counted towards the cost cap for the desalination facilities, so long as California American Water has not exceeded the aggregate of the cost cap amounts for the desalination facilities and the CAW-Only Facilities.

7.3 Ratemaking Process for the CAW-Only Facilities Once Approved by a Commission Decision in This Proceeding

(a) California American Water will track the costs for the CAW-Only Facilities and the \$35.1 million of Surcharge 2 collections in the memorandum account established pursuant to Section 6.8(a). The memorandum account will accrue AFUDC at a rate of the actual cost of funds used to fund the entire project.

(b) The memorandum account will track the CAW-Only Facilities and Surcharge 2 collections separately in the account and will accrue AFUDC at a rate of the actual cost of funds used to fund the project costs. The rate shall be adjusted quarterly to reflect the latest funding costs and will be added into the facility portion of the memorandum account if the total accumulations in the expenditure portion of the memorandum account exceeds the Surcharge 2 collection portion of the memorandum account, or the AFUDC will be added to the Surcharge 2 collection part of the memorandum account if the Surcharge 2 collection portion of the memorandum account exceeds the accumulation in the expenditure portion of the memorandum account.

(c) Once the CAW-Only Facilities are used and useful, California American Water will file a Tier 2 advice letter to put the balance of the memorandum account into rates by increasing the plant in service by the balance of the CAW-Only Facilities portion of the memorandum account and increase Contributions-In-Aid of Construction by the balance of the Surcharge 2 portion of the memorandum account.

8. OPERATIONS & MAINTENANCE COSTS

8.1 Estimates

(a) The Parties agree that estimated net operations and maintenance costs⁶ of \$11.13 million for the 9.6 mgd plant and \$9.12 million for the 6.4 mgd plant are reasonable for developing an estimate of total costs of the MPWSP for purposes of a settlement in this proceeding. These costs include power costs, labor costs, chemical costs, membrane and media replacement costs, and repair and replacement costs.

(b) These revised estimates address issues raised by various parties and include compromises made in order to reach agreement for the purpose of this Settlement. When taken as a whole, and based on the currently available information, these estimates provide a reasonable basis for the Commission to reach a decision.

(c) The Parties agree that estimates for use in setting the actual estimated operations and maintenance costs for development of the revenue requirement to be paid by the customers for the period up until the first test year from the first case filed after at least one full year of operation of the plant will be determined as described below in Section 8.3 (a) below. Estimates of costs beyond this initial period will be determined as described in Section 8.3 (d) below.

8.2 Power Costs

(a) In an effort to achieve lower electricity rates for the desalination plant, alternative means of obtaining energy shall be considered as a means to identify the most optimum combination of power from multiple sources. Such consideration involves the potential use of power from landfill gas in combination with power from the Pacific Gas &

⁶ Net operations and maintenance costs includes all costs to operate the plant less the costs that are anticipated to be saved as a result of reducing the same such costs of operating facilities that prior to the plant have been necessary to provide water service to customers.

Electric Company (“PG&E”) grid. California American Water agrees to retain an outside consultant to study the various PG&E tariffs for possible transmission main installation(s) and how these tariffs would change with the introduction of power from the land fill gas, all in an effort to seek the lowest cost power to the Plant. Additionally, the outside consultant will review the power quality to insure a safe and reliable power supply to the Plant. California American Water shall provide a copy of the study to the Governance Committee and DRA.

8.3 Ratemaking Process

(a) California American Water will provide updated operations and maintenance costs to the Commission at least 60 days prior to the time the plant becomes operational and delivers water into the distribution system for provision to customers. The notification will be made by a Tier 2 advice letter. This filing will determine the level of costs to be used in setting the initial revenue requirement for the MPWSP.

(b) The Parties agree that California American Water shall be authorized by the Commission to establish a MPWSP Operations and Maintenance memorandum account to track the differences between estimated costs adopted through the Tier 2 advice letter process and the actual incurred costs during the period of time from the beginning operation of the plant until the time an estimate of such future costs is filed as part of a future general rate case application, as described in Section 8.3 (d) below.

(c) In the first general rate case application after at least one full year of operation of the facilities, California American Water will “true up” the difference between the estimated and actual operations and maintenance costs tracked in a memorandum account and seek recovery of all reasonable and prudent differences.

(d) Estimates of operations and maintenance costs, after at least one full year of operation of the plant, will be included in the next to be filed general rate case application, and thereon forward, as part of each succeeding general rate case process.⁷

9. ENVIRONMENTAL FACTORS

9.1 Beach Erosion

(a) As part of the design process for any part of the MPWSP desalination plant (including but not limited to slant wells and associated wellhead facilities (“Beach Infrastructure”)) to be located on or beneath the beach, submerged lands, tidelands, or dunes, California American Water shall do all of the following:

(i) Engage at least one geologist, geomorphologist and/or coastal engineer, as appropriate, familiar with the conditions at the specific site proposed for the Beach Infrastructure, to serve as a consultant with regard to the tasks described in this section and any

⁷ The next general rate case application is scheduled to be filed on July 1, 2019 (“2019 GRC”). For an estimate of operations and maintenance costs to be included in the 2019 GRC, the plant would have to be operational in the first quarter of 2018. If the plant is not operational in the first quarter of 2018, then the first estimate of the future costs to be provided in a rate case would be at the earliest in the case to be filed on July 1, 2022.

other beach erosion issues. The consultant(s) shall be jointly selected by Surfrider and California American Water.

(ii) Develop adequate factors of safety, including setback requirements, for Beach Infrastructure and other design criteria that must be met to protect Beach Infrastructure throughout its proposed economic life, through analysis of the relevant factors affecting beach erosion at the specific site proposed for the Beach Infrastructure, including without limitation the following: megacusps, extreme storm events, predicted sea level rise scenarios, sand mining, and seasonal variability.

(iii) As part of the permitting process, develop an adaptive management plan that outlines how all Beach Infrastructure will be relocated or otherwise adapted during the course of the project's lifespan in response to impacts from erosion. To comply with Coastal Act policies, the adaptive management plan should avoid management strategies which require the use of shoreline armoring or beach nourishment.

(iv) Consider the use, for all relevant analyses and design decisions, the erosion rates contained in the currently pending Monterey Bay Sanctuary Foundation Erosion Study (completion expected in late 2013); and further consider any other relevant information.

(v) Review and consider at least the following studies:

Philip Williams & Associates (PWA), E. Thornton, J. Dugan, Halcrow Group, (2008). "Coastal Regional Sediment Management Plan for Southern Monterey Bay." Prepared for Association of Monterey Bay Area Governments (AMBAG).

Mark D. Orzech, Ad J.H.M. Reniers, Edward B. Thornton, Jamie H. MacMahan, (2008). "Megacusps on rip channel bathymetry: Observations and modeling." *Coastal Engineering* 58, 890-907.

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(b) California American Water shall promptly and upon completion provide to all Parties and the Governance Committee written descriptions of the safety factors developed pursuant to Section 9.1(a)(ii), the adaptive management plan developed pursuant to Section 9.1(a)(iii), and a copy of the first set of design drawings or criteria incorporating the

erosion rates discussed in Section 9.1(a)(iv) above, indicating the features that reflect those rates.

(c) The measures in this section are not intended to preclude or preempt any mitigation measures that may be identified in the Final EIR for the MPWSP and adopted by the Commission. If any such mitigation measure in the Final EIR is inconsistent with any measure herein, California American Water shall comply with the adopted mitigation measure in the Final EIR.

9.2 Energy Minimization and Greenhouse Gas Reduction Plan

(a) California American Water will develop and implement an Energy Conservation Plan for the desalination plant for the purpose of reducing energy consumption, ensuring cost effectiveness, and reducing greenhouse gas emissions. The Plan will evaluate the energy demands for both electrical and natural gas for selected project options against the energy demands involved with the direct use of electricity from the PG&E grid. Upon completion, California American Water shall provide a copy of the Plan to the Commission and the parties to this proceeding.

(b) The measures in this section are in addition to, and do not preclude or preempt, any mitigation measures that may be identified in the Final EIR for the MPWSP and adopted by the Commission. If any such mitigation measure in the Final EIR is mutually exclusive with any measure herein, California American Water shall comply with the adopted mitigation measure in the Final EIR.

10. CONTINGENCIES

10.1 Order of Contingencies

(a) The Parties have agreed to re-order the contingency options as presented in Exhibit CA-12, Attachment 9, and to supplement the options to be considered in the event that the MPWSP cannot be implemented as currently proposed. The Parties agree that California American Water should consider contingencies in the order described below. If a given contingency presents potential for excessive costs, significant and unavoidable environmental impacts, comparative delay, and/or substantial permitting risk, California American Water may consider the next highest-ranked contingency. There are three categories of contingencies: intake contingencies, discharge contingencies, and site contingencies.

(b) This Agreement does not reflect any Party's support or endorsement of a particular contingency option. The Parties reserve the right to support or oppose any contingency before the Commission or in any other court or agency proceeding. The Parties recognize that any change to the MPWSP, including the implementation of any of the contingencies listed in this Agreement, will be subject to CEQA, and will be addressed either in the EIR anticipated to be released by the Commission or through a subsequent CEQA compliance process.

(c) In the event that all of the contingencies listed in this Settlement Agreement prove technically or legally infeasible, California American Water may pursue other options proposed in its application in this proceeding. If California American Water chooses to pursue any open-ocean intake contingency, it shall file a petition to modify the decision or appropriate filing to the Commission.

10.2 Intake Contingencies

If California American Water determines that the proposed intake wells for the MPWSP are legally or technically infeasible, the Parties agree that intake contingencies, each of which would provide source water to the desalination plant to the proposed site on Charles Benson Road, should be considered in the order below. The Parties agree that based on input from state and federal regulatory agencies the preferred location for the test well and production wells is within the active mining location at the CEMEX property south of the dredge pond.

Intake Option 1: Ranney collectors at CEMEX property that extract seawater from the Sand Dunes formation.

Intake Option 2: Slant well intake system at Potrero Road with seawater pumped to the desalination plant at the Charles Benson Road site.

Intake Option 2a: Slant well or Ranney collector intake system at Moss Landing with seawater pumped to the desalination plant at the Charles Benson Road site.

Intake Option 2b: Slant well or Ranney collector intake system at both Moss Landing and Potrero Road with seawater pumped to the desalination plant at the Charles Benson Road site.

10.3 Discharge Contingencies

The Parties agree that the following discharge contingencies should be considered in the following order:

Discharge Option 1 (Brine Diffusers): Modify outfall by inserting separate pipe for brine discharge, and adding dedicated pressurized brine diffusers at the end of the outfall.

Discharge Option 2: Install new outfall off-shore of CEMEX property, and adding dedicated pressurized brine diffusers at the end of the outfall.

Discharge Option 3 (Modified Marine Refractory Outfall): Construct brine pipeline to Moss Landing and discharge to the existing Marine Refractory Outfall, with addition of pressurized brine diffusers.

10.4 Siting Contingencies

If any of intake contingency Option 2, 2a, or 2b are chosen and discharge contingency Option 3 is chosen, the parties agree the site at the Charles Benson Road would no longer be

advisable due to the increased cost of pipelines and the Parties agree that siting contingencies should be considered in the following order::

Siting Option 1: Slant wells or Ranney Collector at Potrero Road, desalination plant at the site proposed for Dolan Road in the Final EIR for Commission proceeding number A.04-09-019, discharge to Marine Refractory outfall, with the addition of pressurized brine diffusers

Siting Option 2: Slant wells or Ranney Collector at Potrero Road, desalination plant at the site proposed for Dolan Road in the Final EIR for Commission proceeding number A.04-09-019, discharge to new outfall with pressurized brine diffusers.

11. SECURITIZATION

11.1 Amount

California American Water agrees to finance a portion of the MPWSP with a tax exempt securitization, set at an amount that will allow California American Water to maintain a fixed equity investment equal to approximately 27.0% of the value of the total project costs for the desalination plant and the CAW-Only Facilities and which allows for collections from Surcharge 2 as defined below. Examples of calculations using this financing for both the 9.6 mgd and 6.4 mgd plant size are provided in Appendix 2.

11.2 California American Water shall have the opportunity to invest equity in the MPWSP such that it has the opportunity to earn its authorized rate of return. The Parties agree that California American Water will be taking on significant risk with the MPWSP and some equity investment serves the public interest. The securitization must allow California American Water to maintain a fixed equity investment equal to approximately 27% of the total cost of the MPWSP facilities upon completion of the financing. The proceeds from the securitization need to be received by California American Water in a manner such that State Revolving Funds (SRF) (or other long-term debt in the event SRF is not available and equity) can be used to balance the fixed equity investment to approximate as close as possible to the equity amount of 27% of the total costs for the desalination plant and CAW-Only Facilities. Further, SRF (or other long-term debt in the event SRF is not available and equity) used to pay off any short-term debt provided by California American Water during construction would also be available to balance the fixed equity investment target. Examples of the sources and uses of each component of financing is referenced in Section 15 and included as Appendix 3.

11.3 Criteria

The Parties agree that using securitization as a component of financing for the MPWSP costs is only reasonable if the following conditions are met:

- (a) The securitization lowers the cost to customers. The Parties agree that as a reasonable benchmark to ensure that sufficient benefits accrue to customers, the estimated annual customer benefits must, at a minimum, exceed 1.0% of the total annual revenue requirement for the MPWSP facilities.

(b) The securitization does not adversely affect other California American Water customers within California American Water's other service areas outside of the Monterey County District. Securitization shall only be used to finance the costs of the desalination plant and CAW-Only Facilities so long as it will not negatively impact the credit ratings of American Water or its affiliate American Water Capital Corporation, or in the event that California American Water is a stand-alone entity, then so long as the securitization will not negatively impact the credit ratings of California American Water, computed as a stand-alone entity. This will be determined by the letters from the ratings agencies provided for below.

(c) The securitization does not require a separate California American Water-specific credit rating.

(d) The securitization does not change California American Water's debt-to-equity ratio for the portion of the MPWSP costs not financed with securitized funds. Excluding the securitization amount and any equity related to California American Water's investment in the Special Purpose Entity ("SPE"), California American Water will balance the remaining MPWSP costs with debt and equity at its authorized ratio. California American Water's currently authorized debt-to-equity ratio is 47% to 53%.

(e) The securitization does not change California American Water's authorized rate of return on equity. California American Water's currently authorized rate of return on equity is 9.99%.

(f) The securitization does not materially delay the MPWSP. The securitization amount must be available in a manner to allow for SRF (or other long-term debt in the event SRF is not available and equity) to be used to balance the equity target as discussed in Section 11.2.

(g) The securitization does not create a taxable event for California American Water. The tax impacts of securitization must be considered as part of the customer benefit analysis determination and must be recoverable in rates. The Parties agree that there shall be no adverse tax implications that might accrue to the Monterey County District or other California American Water customers.

11.4 Implementation

(a) To implement the securitization, California American Water will establish a SPE, which will issue debt that will be purchased by the public agency, which in turn will issue financing. The public agency will issue the financing through "Water Rate Relief Bonds" and lend the proceeds to the SPE. California American Water will sell to the SPE a property right consisting of the right to impose, collect, and adjust from time to time a non-bypassable charge to California American Water customers. The sale of the property right by California American Water will be a true sale for bankruptcy purposes. The payment of principal and interest on the Water Rate Relief Bonds are provided for through the non-bypassable charge received by the SPE and remitted to the public agency for payment of principal and interest on the Water Rate Relief Bonds.

(b) The securitization will be non-recourse to California American Water and a default of the bonds will not be a default of California American Water.

(c) The securitization will be of a long-term nature (20-30 years), with a preference for 30 years.

(d) Under Rev. Proc. 2005-62, California American Water will be required to capitalize the SPE. California American Water will capitalize the SPE at the minimum amount that is required to have it accounted for as a legally distinct entity and to provide reserves as needed. The amount of capitalization is expected to be approximately 1% of the Water Rate Relief Bonds. California American Water will place this amount in rate base and will earn interest on the amount at California American Water's then-authorized rate of return.

(e) Securitization will require authorization from the California legislature and a financing order from the Commission. The legislation will authorize the creation of the property right to impose, collect, and adjust from time to time the non-bypassable charge to California American Water customers sufficient to pay off the securitization. The legislation will authorize the Commission to issue a financing order to enable the financing.

(f) There shall be automatic true-up adjustments of the securitization surcharge, as necessary, to ensure sufficient funds for the timely payment of securitization principal, interest, and related costs. The Parties agree that such adjustments shall be done through a Tier 1 advice letter.

(g) The public agency will secure the legislation from the California legislature for the securitization. The public agency will structure the financing and obtain the necessary documentation. The public agency will obtain the rating for the financing and arrange for sale of the debt.

(h) The public agency will endeavor to structure the securitization in a manner that will permit California American Water to avoid significant cash management costs. The Parties shall pursue a system of cost management approach that satisfies the requirement of securitization without resulting in excessive costs.

(i) California American Water will file an application with the Commission for a financing order pursuant to the legislation. To the extent necessary, California American Water will establish any internal financial separation systems required for the securitization. Any costs that are necessary will be added to working cash and recovered as set forth below.

(j) In the course of having the bonds rated by Standard & Poors and Moody's ratings agencies, the public agency will request a letter from each of the rating agencies that will affirm that the securitization will not negatively impact the credit of California American Water, as a stand-alone entity, or American Water.

(k) The public agency agrees to provide a legal opinion that the proposed securitization does not create a taxable event for California American Water.

11.5 Use of Proceeds and Recovery of Costs

- (a) The proceeds of the securitization will be used for the following:
 - (i) Financing the MPWSP at the agreed-upon level.
 - (ii) Reimbursement of public agency fees and expenses associated with securitization.
 - (iii) California American Water will be reimbursed for all fees and expenses it incurs as a result of the securitization effort, including carrying cost on such fees and expenses at the actual cost incurred to fund such efforts (as referenced in Section 14.3). The reimbursement will occur at the time the securitization is funded.
- (b) If the securitization is not successful, California American Water may recover all of its reasonably and prudently incurred costs related to the securitization from customers in the Monterey County District. California American Water will track its securitization costs as debit entries in a new subset of the Surcharge 1 memorandum account until such time as the Commission approves the Surcharge 2 project collection memorandum account, at which time the expenditures will be offset against the Surcharge 2 collection portion of the project construction cost memorandum account.
- (c) If California American Water is shown to have been negatively impacted by the securitization at any time over the amortization period of the bonds, California American Water may seek a determination of the impact in the Cost of Capital or other applicable Commission proceeding and may recover the cost of the negative impact from the customers in the Monterey County District. If California American Water is shown to have been negatively impacted by the securitization at any time after the issuance of the bonds but over the life of the bonds, California American Water may seek a determination of the impact in the Cost of Capital or other applicable Commission proceeding and may recover the cost of the negative impact from the customers in the Monterey County District.

11.6 Contingency

- (a) If the public agency is unsuccessful in obtaining a tax-exempt securitization, the public agency may pursue an alternative form of public agency contribution (Proposition 218 process) if such contribution is feasible, will result in lower costs to customers, and will be accomplished to meet all of the requirements of Section 11.1 through 11.5.
- (b) However, understanding the urgency to finance, construct and bring the desalination project on line, California American Water stands ready to provide long-term debt financing (either through American Water Capital Corporation or the California Pollution Control Financing Authority, whichever is lowest cost to customers) and equity financing.

12. SURCHARGE 2

12.1 Collection

(a) The total to be collected under Surcharge 2 will be reduced to an estimated \$71.5 million in order to provide for a smooth transition in rates from the final period under Surcharge 2 to the year 1 revenue requirement of the desalination plant. Surcharge 2 will be determined as a percentage of base revenues and adjusted semi-annually to target \$71.5 million in revenue. If Surcharge 2 collections fall short of the \$71.5 million target, any remaining undercollection will be funded with SRF debt (or company debt if SRF is not available) and equity.

(b) California American Water agrees to treat Surcharge 2 collections as contributions, and that in the case of condemnation or sale of the assets to which it applies, that California American Water would subtract the amount contributed to the MPWSP via Surcharge 2 from any valuation used in the sale or condemnation of these assets.

(c) California American Water agrees that Surcharge 1 will cease before Surcharge 2 collections begin to allow for a more gradual ramping up of rates that are directly attributed to the MPWSP. To ensure smooth transition from the Surcharge 1 collections to the implementation of Surcharge 2, the Parties agree that the rate of collection for Surcharge 1 shall increase to 20% at a time of a decision in this proceeding and that it again shall increase to 30% six months later so that it equals the implementation surcharge percentage for Surcharge 2.

(d) California American Water will track in a memorandum account the difference between the estimated total of \$71.5 million of total collections and actual revenues collected under Surcharge 2. California American Water will file a Tier 1 advice letter quarterly to “true up” these total amounts and propose a new surcharge rate for collection that is estimated to allow for collection of the entire \$71.5 million. As stated above any excess funds collected as a difference between total spend on either the CAW-Only Facilities memorandum account and the MPWSP costs memorandum account will accrue interest at the same rate established for AFUDC in Paragraph 7.3(b) above.

(e) California American Water will track in the Surcharge 2 memorandum account the difference between the estimated revenue needed to accumulate \$71.5 million in total collections and actual revenues collected under Surcharge 2. California American Water will file a Tier 1 advice letter quarterly to “true up” these amounts. Any surplus Surcharge 2 funds (Surcharge 2 funds in excess of desalination project costs) would earn AFUDC as stated in Paragraph 7.3(b) above.

12.2 Use of Surcharge 2

(a) California American Water agrees to apply the initial \$35 million of funds collected under Surcharge 2 to the CAW-Only Facilities. The remaining \$36.5 million collected under Surcharge 2 would be applied to the desalination plant costs after permits required to commence construction have been obtained, and provided that if litigation has

been filed concerning the MPWSP, no court has issued a temporary injunction or stay of the MPWSP pending the outcome of the litigation.

(b) California American Water agrees that if the MPWSP is stalled (e.g., judicial injunction or declaration by California American that development of the MPWSP has been suspended) for an estimated 3-month period or longer, it will cease collecting Surcharge 2 and collection will not again be initiated until California American Water has filed a Tier 1 advice letter showing that the MPWSP can again move forward. If the MPWSP terminates, California American Water will file an application with the Commission within 120 days proposing a method to return to customers any Surcharge 2 collections that are over and above the prudently incurred costs.

13. SRF FINANCING

13.1 SRF financing remains the preferred option for debt financing for both the desalination plant and the CAW-Only Facilities. SRF will be utilized in proportion to the amount of equity financing necessary to maintain a balanced capital structure. The capital structure will exclude the amount of securitization bonds, assuming the securitized bonds meet the criteria discussed above.

13.2 If California American Water is not successful in its attempt to obtain SRF funds on its own accord, it agrees to work with a public agency to secure these funds. California American Water will, at its sole discretion, select as a partner for pursuing SRF financing from among capable and willing public entities. If for some reason, SRF funds are not available under any circumstance, then California American Water, through American Water Capital Corporation, stands ready to provide long-term debt financing.

13.3 SRF loans shall be treated for ratemaking purposes just as the Commission has previously determined in D.05-01-048. SRF loans will be treated as debt on California American Water's financial statements for financial reporting purposes.

13.4 California American Water will file a separate application for a financing order from the Commission approving SRF funding. It will file an advice letter to put the changes approved in that order into rates.

13.5 The Parties recognize the value in California American Water providing to the Parties documentation as soon as possible from the SWRCB demonstrating California American Water's ability to secure SRF financing. California American Water shall actively pursue such documentation and shall provide it to the Parties when available. The Parties also recognize that documentation will not likely be forthcoming until the Commission has certified its EIR. California American Water shall alert the Parties should it obtain any information suggesting SRF financing may not be available or may require a public agency partner.

14. RATEMAKING

14.1 The revenue requirement for the rate base portion of the desalination plant and the CAW-Only Facilities will be based on the current and effective cost of capital decision approved by the Commission, and subject to future adjustment as the cost of capital changes. However,

the interest rate on the securitization and SRF or long-term debt will be set at the time of funding and will be recovered in accordance with procedures set forth in Section 11 and Section 12.

14.2 Property taxes shall be included in the revenue requirement of the MPWSP in compliance with the findings of the tax assessor.

14.3 Depreciation rates on all facilities will be determined based on the latest rates filed with the Commission in either a general rate case or via the annual depreciation adjustment filing made in conjunction with Section 11.21 of the settlement agreement approved by the Commission in D.12-06-016.

14.4 AFUDC shall be allowed on all construction work in progress related to the desalination plant facilities at the actual rate of the instruments used to finance the construction.

14.5 Income Taxes will be calculated as part of the revenue requirements based on the same procedures and at the same rates as established in the latest authorized general rate case decision.

14.6 First Year Revenue Requirement Determination for the Desalination Facilities including the CAW-Only Facilities

(a) Upon completion of the desalination facilities, California American Water shall determine the first year revenue requirement for the desalination facilities including the CAW-Only Facilities. At the time California American Water implements the first year revenue requirement for both such facilities, the authorization will supersede any previously established revenue requirement for the CAW-Only Facilities as authorized by Section 7.3 (c).

(b) The first year revenue requirement will be determined based on the above assumptions and those established in Section 8.3.

(c) The revenue requirement will be placed into base rates via the tier 2 advice letter process, and will increase the authorized revenue requirement for the Monterey County District, the same as any other authorized plant offset advice letter request, except that the increase will only be applicable to customers as determined by the Commission in a later phase of this proceeding.

14.7 Revenue Requirements Beyond Year One

(a) The new revenue requirement as determined in Section 14.6 will remain in place until such time as the revenue requirement of the plant and CAW-Only Facilities are considered in a subsequent GRC.

(b) Operation and maintenance estimates will be determined based on the procedures as set in Section 8.3.

15. PROJECT CASH FLOW

15.1 California American Water agrees to provide \$20 million in short term debt to be used during construction as a means of reducing AFUDC.

15.2 A proposed cash flow statement is provided as Appendix 3 that takes into account all sources of financing agreed to by the parties.

16. GOVERNANCE

16.1 The Parties agree that the Governance Committee Agreement, as adopted March 8, 2013 (attached as Appendix 1) provides for consideration of community values and will ensure public agency representation in important aspects of the MPWSP. The parties to the Governance Committee Agreement agree to consider revisions to the Governance Committee Agreement to address the bifurcated GWR procedure set forth in Section 4.3 above and potential submission of written statements concerning GWR findings from the Governance Committee to the Commission as specified in Section 4.3(d). The Parties encourage the Commission to expressly condone, within its decision in this proceeding, California American Water's participation in the Governance Committee consistent with the terms of the Governance Committee Agreement, as potentially modified to address the change in the GWR proceeding as discussed above.

17. CONDITIONS

17.1 This Settlement Agreement is without prejudice to any Party's right to take part to the full extent provided by law in any state, local, or federal permitting or other entitlement process related to the MPWSP. Notwithstanding such right, the Parties agree, subject to any reservations and/or exceptions contained in this Settlement Agreement, to support or not oppose all provisions included in this Settlement Agreement in any such process, and shall not advocate in any such process a position inconsistent with any provision in this Settlement Agreement. Any Party with the legal authority or obligation to issue any permit or entitlement for the MPWSP shall maintain its full legal authority and discretion to determine whether or not to issue such permit or entitlement.

(a) In the event any Party believes another Party has breached its obligations under this provision, the Party alleging breach shall provide the allegedly breaching party written notice and a 30-day opportunity to cure the alleged breach. The Parties agree that injunctive relief, and injunctive relief alone, is the appropriate means to enforce this provision. No Party shall be subject to any claim for money damages as a result of a breach of this provision.

17.2 Because this Settlement Agreement represents a compromise by them, the Parties have entered into each stipulation contained in the Settlement Agreement on the basis that its approval by the Commission not be construed as an admission or concession by any Party regarding any fact or matter of law in dispute in this proceeding.

17.3 The Parties agree that no signatory to the Settlement Agreement assumes any personal liability as a result of this Settlement Agreement. The Parties agree that the

Commission has primary jurisdiction over any interpretation, enforcement, or remedy pertaining to this Settlement Agreement.

17.4 The Parties agree that the Settlement Agreement is an integrated agreement such that if the Commission rejects or modifies any portion of this Settlement Agreement, each Party must consent to the Settlement Agreement as modified, or any Party may withdraw from the Settlement Agreement. Such consent may not be unreasonably withheld. As between the Parties, this Settlement Agreement may be amended or changed only by a written agreement signed by all of the Parties.

17.5 The Parties agree to use their best efforts to obtain Commission approval of the Settlement Agreement. The Parties shall request that the Commission approve the Settlement Agreement without change and find the Settlement Agreement to be reasonable, consistent with the law, and in the public interest.

17.6 This Settlement Agreement may be executed in counterparts, each of which shall be deemed an original, and the counterparts together shall constitute one and the same instrument. Each of the Parties hereto and their respective counsel and advocates have contributed to the preparation of this Settlement Agreement. Accordingly, the Parties agree that no provision of this Settlement Agreement shall be construed against any Party because that Party or its counsel drafted the provision.

17.7 This Settlement Agreement supersedes any prior representations by the Parties regarding each stipulation contained herein.

18. COMMISSION MODIFICATION OF SETTLEMENT AGREEMENT

18.1 If the Commission approves the Settlement Agreement with modifications, the Parties request the Commission to provide a reasonable period for the Parties to consider and respond to such modification.

18.2 If the Commission approves the Settlement Agreement with modifications, each Party shall determine no later than two business days before the deadline imposed by the Commission for acceptance of the modification whether it will accept the modification and shall notify the other Parties of its determination.

18.3 If any Party declines to accept the Commission's modification, the other Parties may still accept the modification and request the Commission to approve the revised Settlement Agreement in the absence of the agreement of the Party or Parties who decline to accept the Commission's modification; provided, however, that Parties who accept the modification and request approval of a revised Settlement Agreement may not accept the modification and request the Commission to approve the revised Settlement Agreement if the applicant California American Water is among the Parties who decline to accept the Commission's modification. If the Commission's proposed modification of this Settlement Agreement is not consented to by California American Water, the Settlement Agreement shall be void and the Commission will establish a procedural schedule to address the disputed issues.

July 31, 2013

CALIFORNIA-AMERICAN WATER
COMPANY

By: 
Robert MacLean, President

July____, 2013

CITIZENS FOR PUBLIC WATER

By: _____
George T. Riley

July 30, 2013

CITY OF PACIFIC GROVE

By: Heidi Quinn for
Thomas Frutchey, City Manager

July 31, 2013

COALITION OF PENINSULA BUSINESSES

By: 

Bob McKenzie

July 30, 2013

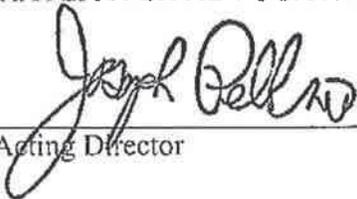
COUNTY OF MONTEREY

By: *Fernando Armenta*
Fernando Armenta

July 31, 2013

DIVISION OF RATEPAYER ADVOCATES

By:

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Joe Como, Acting Director

July 30, 2013

LANDWATCH MONTEREY COUNTY

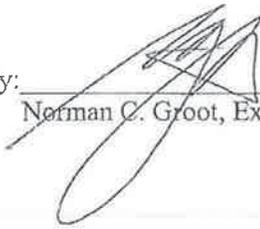
By:

Chris Fitz

A handwritten signature in black ink, appearing to read 'Chris Fitz', written over a horizontal line. The signature is stylized and cursive.

July 31, 2013

MONTEREY COUNTY FARM BUREAU

By:  _____
Norman C. Groot, Executive Director

July 31, 2013

MONTEREY COUNTY WATER
RESOURCES AGENCY

By: 
David E. Chardavoyne, General Manager

July 31, 2013

MONTEREY PENINSULA REGIONAL
WATER AUTHORITY

By: Chuck Della Sala
Chuck Della Sala

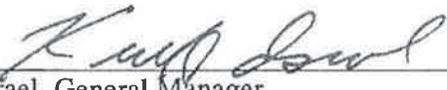
July 30, 2013

MONTEREY PENINSULA WATER
MANAGEMENT DISTRICT

By: 
David J. Stoldt - General Manager

July 31, 2013

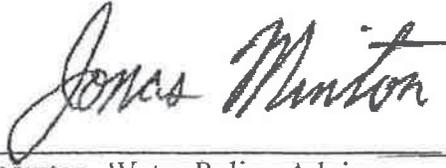
MONTEREY REGIONAL WATER
POLLUTION CONTROL AGENCY

By: 
Keith Israel, General Manager

July __, 2013

PLANNING AND CONSERVATIONS
LEAGUE

By: _____

A handwritten signature in cursive script that reads "Jonas Minton". The signature is written in black ink and is positioned above a horizontal line.

Jonas minton, Water Policy Advisor

July 30, 2013

SALINAS VALLEY WATER COALITION

By: Nancy Isakson
Nancy Isakson

July 31, 2013

SIERRA CLUB

By: Laurens H. Silver
Laurens H. Silver

July 31, 2013

SURFRIDER FOUNDATION

By:  _____
Gabriel M. Ross

Appendix 1

**AGREEMENT TO FORM THE
MONTEREY PENINSULA WATER SUPPLY PROJECT GOVERNANCE COMMITTEE**

This **AGREEMENT TO FORM THE MONTEREY PENINSULA WATER SUPPLY PROJECT GOVERNANCE COMMITTEE** (“**Agreement**”) is made and entered into as of March 8, 2013, by and among the **MONTEREY PENINSULA REGIONAL WATER AUTHORITY** (“**MPRWA**”), the **MONTEREY PENINSULA WATER MANAGEMENT DISTRICT** (“**MPWMD**”), the **COUNTY OF MONTEREY** (“**County**”), and the **CALIFORNIA-AMERICAN WATER COMPANY** (“**Cal-Am**”). The MPRWA, the MPWMD, the County, and Cal-Am are sometimes referred to individually herein as a “**Party**,” and collectively as the “**Parties**.”

I. Formation of Governance Committee

Pursuant to the terms of this Agreement, the Parties hereby form the Monterey Peninsula Water Supply Project Governance Committee (“**Governance Committee**”) comprised of representatives of the MPRWA, the MPWMD, the County, and Cal-Am to ensure efficient and effective public input into the development and operation of the Monterey Peninsula Water Supply Project (“**Project**”). Cal-Am’s entry into this Agreement is expressly conditioned upon its legal obligations to abide by the orders and decisions of the California Public Utilities Commission (“**CPUC**”). Therefore, should the CPUC order Cal-Am not to participate in this Agreement, Cal-Am shall be relieved of all obligations set forth in this Agreement and this Agreement may be terminated by Cal-Am upon such CPUC order. Further, if the CPUC issues any order or decision that conflicts with any particular provision of this Agreement, Cal-Am shall be relieved of any and all obligations to abide by the conflicting provision of this Agreement.

II. Definitions

A. Application A.12-04-019. Application of California-American Water Company (U210W) for Approval of the Monterey Peninsula Water Supply Project and Authorization to Recover All Present and Future Costs in Rates, filed with the CPUC on or about April 23, 2012.

B. ASR Infrastructure. The facilities used to inject into and extract potable water from the Seaside Groundwater Basin, as described in Application A.12-04-019. These facilities will include the Aquifer Storage and Recovery (“ASR”) wells and related appurtenances, the backflush pipeline, the recirculation pipeline and the ASR pipeline.

C. Brine Discharge Infrastructure. Facilities located outside the desalination plant site that are used to dispose of brine into the ocean. These facilities will include the brine disposal pipeline, the brine receiving station, any modification to the MRWPCA existing outfall, or a new outfall, or potentially the use of other existing outfalls with or without modifications.

D. Cal-Am Notification. The written notification from Cal-Am to the Chair of the Governance Committee that a matter is ready for consideration, consultation, or action by the Governance Committee as provided herein, and as further defined within Section V.B.

E. CEQA. The California Environmental Quality Act.

F. Contracts. One or more of the contracts between Cal-Am and a selected contractor, valued in excess of \$1 million, relating to the design and/or construction of the following facilities: (1) the Desalination Infrastructure, (2) the Source Water Infrastructure, (3) the Brine Discharge Infrastructure contracted for by Cal-Am, (4) the Product Water Pipeline, (5) the Raw Water Pipeline; (6) the ASR Infrastructure, and (7) the Terminal Reservoir Infrastructure. Contracts for one or more of the facilities identified above in this definition may be combined into a single contract. In addition, the design and construction of a single facility identified above in this definition may be combined into a single contract.

G. CPCN. The Certificate of Public Convenience and Necessity, if ordered by the CPUC, within Application A.12-04-019.

H. Desalination Infrastructure. Facilities located within the desalination plant site that are used to create potable water from either an ocean source water, brackish source water or a combination thereof, and appurtenant facilities needed to dispose of brine to the Brine Discharge Infrastructure, dispose of wastewater (i.e. process water and sanitary discharge), and any needed facilities that may be required to prevent export of native Salinas River Groundwater Basin water.

I. Desalination Project. The combination of the Desalination Infrastructure, the Brine Discharge Infrastructure, the Source Water Infrastructure, the Product Water Pipeline, the Raw Water Pipeline, and the Terminal Reservoir Infrastructure.

J. GWR Project. Groundwater replenishment project to be implemented by MRWPCA and/or MPWMD which involves advanced treatment of wastewater and the injection of product replenishment water into the Seaside Groundwater Basin. This project includes facilities for the treatment, conveyance, and injection of the product replenishment water.

K. MRWPCA. The Monterey Regional Water Pollution Control Agency.

L. Product Water Pipeline. Facilities used to convey potable water from the Desalination Infrastructure to the Terminal Reservoir Infrastructure and to Cal-Am's existing distribution system at the Eardley Pump Station.

M. Project. The Monterey Peninsula Water Supply Project as proposed in Application A.12-04-019, and as it may be modified by the CPCN issued in response to that Application.

N. Public Entity Members of the Governance Committee. The MPRWA, the MPWMD, and the County. Cal-Am is not a Public Entity Member of the Governance Committee.

O. Raw Water Pipeline. Facilities used to convey feedwater (i.e., raw water) from the Source Water Infrastructure to the Desalination Infrastructure.

P. Source Water Infrastructure. Wells and appurtenant facilities (or alternative contingent intake facilities) that are used to extract and convey feedwater (i.e., raw water) to the Raw Water Pipeline. These facilities will include the slant intake wells and related appurtenances (if permitted) as well as alternate contingent intakes such as a Ranney Well or open ocean intake as submitted by Cal-Am in its contingency plans.

Q. Terminal Reservoir Infrastructure. Facilities used to pump and store potable water in storage tanks east of the City of Seaside along General Jim Moore Boulevard. These facilities will include the terminal reservoir, terminal reservoir pump station, overflow facilities and related appurtenance needed to assist in the moving of water to and from the ASR Infrastructure, other ASR facilities, and Product Water Pipeline.

R. Value Engineer. The professional engineer(s) to be retained by, or to consult with, Cal-Am to perform a value engineering analysis for the Desalination Project to potentially lower the costs of, or maximize the value of, the Desalination Project to Cal-Am's ratepayers, including matters concerning the cost effectiveness, performance, reliability, quality, safety, durability, effectiveness, or other desirable characteristics of the Desalination Project.

The Parties acknowledge that the Project is still under development and several aspects of the Project may be modified as planning continues and as may be ordered by the CPUC. If necessary to address future modifications to the Project, the Parties agree to cooperate in good faith to reach agreement to amend the definitions set forth herein as necessary to fulfill the purpose of this Agreement.

III. Membership and Voting

Each of the Public Entity Members of the Governance Committee shall be represented on the Governance Committee by one elected official of such entity and one alternate who shall also be an elected official. No individual person may be appointed as the primary or alternate representative of more than one Party. If MPRWA ceases to exist, then the cities that are members of the MPRWA at the time of the MPRWA's termination shall collectively choose a "city representative" that will take the place of the MPRWA representative on the Governance Committee. Cal-Am shall be represented by the President of Cal-Am or the President's alternate, whom the President may designate to act on his or her behalf at anytime. The Governance Committee shall appoint a "Chair" and "Vice-Chair" from the primary (non-alternate) elected officials appointed to the Governance Committee. Each of the Public Entity Members of the Governance Committee shall have a single equal vote in decision-making. Cal-Am shall not have a vote for purposes of the issuance of decisions or recommendations by the Governance Committee. However, Cal-Am shall, unless it abstains from doing so, state its preference with respect to any decision or recommendation made by the Governance Committee (the "**Cal-Am Preference**") at the time that any decision or recommendation is made by the Governance Committee and the Cal-Am Preference shall be recorded within the meeting minutes together with a summary of any explanation provided by Cal-Am for the Cal-Am Preference.

IV. Powers

A. Purpose. The purpose and function of the Governance Committee shall be to: (i) consult with, advise and, in some circumstances, provide direction to, Cal-Am concerning the design, permitting, construction, operations, maintenance, repairs, and replacements of the components of the Desalination Project; and (ii) serve as the entity which Cal-Am regularly updates as to Desalination Project status and issues. The members of the Governance Committee shall diligently consider all matters and cause the Governance Committee to timely and promptly issue decisions or recommendations brought before it as provided pursuant to the terms of this Agreement.

B. Waiver of Action. Upon motion and affirmative vote of the Governance Committee (pursuant to Section VII of this Agreement), the Governance Committee may choose to waive its right to issue a decision or recommendation with respect to any matter for which the Governance Committee is afforded such right herein. The purpose of the Governance Committee's right to waive its right to make any specified decision or recommendation herein is to empower the Governance Committee to avoid issuing any decision or recommendation, which, in its determination, would violate any law, unreasonably delay efforts to develop water supplies for the Monterey Peninsula, or otherwise compromise the public interest.

V. Governance Committee Action; Procedures

A. Matters Subject to Governance Committee Action. Matters for consideration, consultation, decision, or recommendation by the Governance Committee shall be divided among three categories, with varying processes for consultation, recommendations, and/or decision-making, as follows:

Category A: The Governance Committee makes the decision or recommendation respecting the matter after receipt of a written recommendation from Cal-Am, and upon issuance of its decision or recommendation, the Governance Committee provides a written explanation of the reasons for its decision to Cal-Am within seven (7) calendar days following its decision or recommendation. Thereafter, Cal-Am will comply with the decision or recommendation issued by the Governance Committee so long as the decision or recommendation is consistent with the terms of this Agreement. However, notwithstanding any provision of this Agreement, for any matter covered by Category A that relates to an action which may cause either a direct physical change in the environment, or a reasonably foreseeable indirect physical change in the environment, as defined by section 21065 of the California Public Resources Code, no decision or recommendation shall be made by the Governance Committee as to the subject matter unless

and until such time as the action has been subject to review by an appropriate agency in accordance with CEQA. The foregoing provision shall not be construed as an agreement or determination by or among any of the Parties that CEQA applies to any action of the Governance Committee. This Agreement is itself not a “project” as defined by section 15378 of the CEQA Guidelines (California Code of Regulations, Title 14, Chapter 3) because it is an organizational activity that will not result in direct or indirect physical changes in the environment and this Agreement makes no commitment to any project.

Category B: The Governance Committee makes a recommendation respecting the matter after receipt of a written recommendation from Cal-Am. However, Cal-Am may determine, at its sole discretion, whether or not to follow the Governance Committee’s recommendation, provided that if Cal-Am chooses not to follow the recommendation, Cal-Am shall provide a written explanation of Cal-Am’s reasons for its decision not to follow the recommendation within ten (10) calendar days following the issuance of the Governance Committee’s recommendation. Further, should Cal-Am choose not to follow the recommendation of the Governance Committee, then any Party may raise the issue for review by the CPUC during Cal-Am’s next general rate case.

Category C: Cal-Am makes the decision respecting the matter after receiving a recommendation from the Governance Committee. Cal-Am need not issue a written explanation for its decision, although should Cal-Am choose not to follow the recommendation of the Governance Committee, then any Party may raise the issue for review by the CPUC during Cal-Am’s next general rate case.

B. Procedure for Cal-Am Notification. Whenever Cal-Am is presented with, or becomes aware of, a matter that falls within any of the subjects identified herein for consideration, consultation, decision or recommendation by the Governance Committee that is ripe for presentation to the Governance Committee, Cal-Am shall, in writing, promptly notify the Chair of the Governance Committee (“Cal-Am Notification”), who shall schedule the matter for consideration by the Governance Committee. For purposes of this Agreement, a matter shall be deemed ripe for presentation to the Governance Committee at such time as either specified within the matters set forth below, or for any matter for which no specification is provided, Cal-Am shall determine the time(s) at which the matter is appropriate for presentation for consultation, decision, or recommendation by the Governance Committee consistent with the purpose of this Agreement. Unless a different period is specified herein, for all matters for which a decision or recommendation is to be made by the Governance Committee, the Governance Committee shall issue its decision or recommendation within ten (10) calendar days following receipt of the Cal-Am Notification. If the Public Entity Members of the Governance Committee determine that the Governance Committee requires more than the prescribed time period provided for in this Agreement to act on any matter that is the subject of the Cal-Am Notification, the Chair of the Governance Committee may, within seven (7) calendar days following receipt of the Cal-Am Notification, request a reasonable extension of time by written request to Cal-Am, and Cal-Am and the Public Entity Members of the Governance Committee shall cooperate in good faith to agree upon and set a reasonable alternative deadline for action on the subject matter to the extent that such an extension would not unreasonably delay the Project, not unreasonably delay required CPUC filings by Cal-Am, or otherwise compromise the public interest. So as to avoid undue delay, if the Governance Committee fails to make any decision or provide any recommendation upon any matter brought before it (including all Category A decisions) on or before the expiration of the prescribed period for action by the Governance Committee (or the period of any extension agreed to by Cal-Am), or if the Governance Committee affirmatively waives its right to make a decision or recommendation respecting a matter before it, then Cal-Am may make the subject decision without a decision or recommendation, as applicable, by the Governance Committee.

C. Cal-Am Status Presentations and Governance Committee Recommendations Thereon. At each meeting of the Governance Committee, Cal-Am shall provide a report as to the status of the Project, which shall be presented by one or more individuals knowledgeable about the material aspects of the Project. Upon reasonable advance written notice, the Governance Committee may request that Cal-Am include within its status presentation to the Governance Committee the status of any matter that is set forth in any of the three categories for decision, recommendation, or consultation established

below, together with an explanation of any pending or soon-to-be-pending decisions or options concerning the subject matter. The Governance Committee may issue, in writing, any recommendation concerning a subject matter included within Cal-Am's presentation. Cal-Am may determine, at its sole discretion, whether or not to follow the recommendation, provided that if Cal-Am chooses not to follow the recommendation and the subject matter is a matter covered by either Category A or Category B, Cal-Am shall, within ten (10) calendar days following issuance of the Governance Committee's recommendation, provide a written explanation of the reason(s) for Cal-Am's decision not to follow the recommendation. If the subject matter is a matter covered by Category C or is not set forth within any of the three categories set forth below, Cal-Am need not issue a written explanation of Cal-Am's reasons for its decision not to follow the recommendation.

D. Categories for Matters Subject to Governance Committee Action. Matters for consideration, consultation, decision, or recommendation by the Governance Committee shall be divided among the following three categories as follows:

Category A

1. This matter concerns the "GWR Recommendation," which specifically is whether Cal-Am shall: (i) pursue a water purchase agreement, acceptable to Cal-Am, for the purchase of water from the GWR Project, and consequently Cal-Am shall develop smaller Desalination Infrastructure with a capacity of approximately 6.4 MGD (or as specified in the CPCN); or (ii) forgo the pursuit of a water purchase agreement for the GWR Project, and consequently Cal-Am shall develop larger Desalination Infrastructure with a capacity of approximately 9.6 MGD (or as specified in the CPCN). If the GWR Recommendation becomes ripe for recommendation, as specified in the paragraph below, before a CPCN is issued upon Application A.12-04-019, the Governance Committee shall not issue any binding recommendation concerning the GWR Recommendation. If the GWR Recommendation becomes ripe for recommendation, as specified in the paragraph below, after a CPCN is issued upon Application A.12-04-019, the Governance Committee shall decide whether to recommend that Cal-Am pursue the GWR Project or not (as set forth above), which recommendation shall then be subject to CPUC approval or rejection pursuant to the procedure specified herein. The Governance Committee shall make this recommendation based upon criteria to be mutually-agreed to by the Parties, negotiating in good-faith, after the execution of this Agreement.

The GWR Recommendation shall become ripe for a recommendation to be made by the Governance Committee (i) no earlier than the date Cal-Am accepts the 30% Design from the contractor retained for the design of the Desalination Infrastructure, (ii) no later than that date upon which Cal-Am is prepared to issue a notice to proceed to a contractor to commence construction of the Desalination Infrastructure, (iii) after the CEQA lead agency has certified the environmental impact report for the GWR Project and approved the GWR Project, and (iv) while there is sufficient time for the GWR Recommendation to be made and for the CPUC to review and approve that recommendation, without otherwise delaying the Project. The GWR Recommendation shall be made by the Governance Committee, in writing with an explanation of the reasons for its decision, within sixty (60) days following receipt of the Cal-Am Notification concerning this matter. The recommendation issued by the Governance Committee shall be submitted by Cal-Am to the CPUC for approval or rejection pursuant to a Tier 2 Advice Letter (or at the direction of the CPUC, an alternate form of submission) within ten (10) calendar days following issuance of the GWR Recommendation by the Governance Committee for the CPUC's review and approval. To avoid undue delay of the Project, and notwithstanding the ripeness of the GWR Recommendation as described above, if on the date that is ninety (90) days prior to the date upon which Cal-Am anticipates being prepared to issue a notice to proceed to a contractor to commence construction of the Desalination Infrastructure, no public agency has issued a resolution or order that declares that it is prepared to issue a notice to proceed to a contractor to commence construction of the GWR Project, then Cal-Am may make the decision with respect to the GWR Recommendation, in its sole discretion, without soliciting or obtaining the GWR Recommendation from the Governance Committee.

2. The Governance Committee shall select a Value Engineer(s) to facilitate and report on the proposed value engineering for the Desalination Project, with consideration given to any

recommended engineer submitted by any member of the Governance Committee. Cal-Am shall conduct the procurement for the Value Engineer and, consistent with the processes set forth in Categories B(1), B(2) and C(2) relating to Contracts, seek recommendations from the Governance Committee for the contract between Cal-Am and the Value Engineer. After reviewing the results of the procurement process, the Governance Committee shall decide which engineer is to be retained by Cal-Am as the Value Engineer for the Desalination Project. This matter shall be ripe for decision before Cal-Am accepts the 30% Design from the contractor retained for the design of the Desalination Infrastructure, or at any other time that Cal-Am intends to retain a Value Engineer for any other infrastructure constructed as a component of the Desalination Project.

3. Subsequent to the issuance of the CPCN and subsequent to the selection of any design-build contractor(s) for the Desalination Infrastructure, the Governance Committee may issue decisions concerning architectural renderings for the Desalination Project. The Governance Committee shall be presented with architectural renderings for decisions regarding the same when such architectural renderings are complete and upon any subsequent modifications thereto. The Governance Committee may also, in its discretion, appoint a representative to consult with Cal-Am regarding other external features or aesthetics of the Desalination Project. Upon a determination of the Governance Committee or its representative, the Governance Committee's representative and Cal-Am shall present to the Governance Committee options pertaining to the Desalination Project's external feature or aesthetics, upon which the Governance Committee may decide which option to pursue. Notwithstanding any provision of this paragraph, the Governance Committee may not issue a binding decision concerning the Desalination Infrastructure's architectural renderings, or the Desalination Project's external features or aesthetics, if the decision would in the opinion of the design-build contractor, increase the capital or operational cost of the Desalination Infrastructure.

4. Subsequent to the issuance of the CPCN, the Governance Committee may issue decisions concerning procurement of alternative (non-Pacific Gas & Electric) energy supplies for the Desalination Infrastructure, including but not limited to waste-to-energy, so long as such decisions result in lowering the Desalination Infrastructure's estimated unit price for power. This matter shall be ripe for decision at any time a formal written proposal concerning alternative power is presented by one or more of the Parties for consideration.

Category B

1. Prior to the issuance of a request for qualifications, request for proposals, or request for bids, as applicable, relating to the procurement of a Contract, the Governance Committee may recommend qualifications and selection criteria for such Contract.

2. Prior to the execution of any Contract not executed on or before the date that is thirty (30) calendar days after the effective date of this Agreement, and upon presentation and recommendation by Cal-Am to the Governance Committee after Cal-Am has reviewed and evaluated proposals or bids, as applicable, and negotiated with the contractor a Contract that, in the opinion of Cal-Am, is ready for execution by and between Cal-Am and the contractor, the Governance Committee may recommend which contractor should be retained under the Contract, and issue any recommendations concerning the terms of the final Contract. When presenting a Contract to the Governance Committee for its consideration and recommendation, Cal-Am shall provide to the Governance Committee a copy of all responsive proposals or bids received for the pertinent work, except for any proprietary information provided by contractors submitting responsive proposals or bids, together with a written description of the process Cal-Am undertook to select a recommended Contractor, a summary of the considerations that Cal-Am deems pertinent to support its recommendation, and any other information that Cal-Am believes will assist the Governance Committee in its review of the recommended Contract and contractor.

3. The Governance Committee may review and issue recommendations concerning major changes to the Desalination Project at key stages of the design process, including:

- Basis of Design

- 30% Design
- 60% Design
- 90% Design, and
- Final Design

As used in this paragraph, major changes to the Project shall include changes causing an increase or decrease in costs of the Desalination Project that exceed \$1 million.

4. The Governance Committee may issue recommendations concerning the establishment of a community outreach program.

5. The Governance Committee may recommend the Desalination Project's aesthetic attributes and design consistent with community values if not covered by Category A(3) above;

6. The Governance Committee may coordinate with Cal-Am and recommend solutions to issues concerning the use of the Brine Discharge Infrastructure;

7. The Governance Committee may review and recommend whether to adopt any value engineering recommendations issued by the Value Engineer;

8. The Governance Committee may review and recommend whether to approve any change order pertaining to any component or components of the Desalination Project, if the change order exceeds \$1 million.

Category C

1. Cal-Am shall monitor the design, engineering, and permitting of all elements of the Desalination Project, and report on such monitoring to the Governance Committee as described in Section VI. The Governance Committee shall discuss Cal-Am's report and may issue recommendations to Cal-Am pertaining to the Desalination Project;

2. Prior to Cal-Am's commencement of negotiations with a selected contractor relating to a Contract, the Governance Committee may review and issue recommendations concerning contract terms relating to such Contract;

3. The Governance Committee may review and issue recommendations concerning the preparation and quarterly update of an overall construction budget for the Desalination Project;

4. The Governance Committee may review and issue recommendations concerning a plan for acceptance testing, including follow-up reporting, for the Desalination Project;

5. The Governance Committee may annually review and issue recommendations concerning the Desalination Project operations and maintenance budget and rate impacts;

6. The Governance Committee may review and issue recommendations to Cal-Am with respect to local and regional permit requirements; and

7. The Governance Committee may review and issue recommendations concerning the preparation of quarterly progress reports during major design milestones (i.e., 30% design, 60% design, 90% design, and final design) and information on any material challenges to the Project design.

E. Additional Matters. If agreed unanimously by all members of the Governance Committee, including Cal-Am, additional matters not provided for herein may be added to Category A for decision or recommendation by the Governance Committee or to Category B for recommendation from the Governance Committee. Additional matters may also be added to Category C for recommendation

from the Governance Committee upon affirmative vote of the Governance Committee unless Cal-Am determines that the addition of the matter to Category C would unreasonably delay the Project or otherwise compromise the public interest. If Cal-Am determines that a matter affirmed by the Governance Committee for addition to Category C should not be so added, Cal-Am shall issue a written explanation to the Governance Committee within ten (10) calendar days following the Governance Committee's vote to add the matter to Category C that explains the reasons supporting Cal-Am's determination.

VI. Meetings and Action of the Governance Committee; Agendas and Minutes

A. Meetings. Governance Committee meetings shall be conducted in compliance with the Ralph M. Brown Act (Government Code sections 54950, et seq.). The first meeting of the Governance Committee shall be scheduled by the primary representative of the MPWMD, and that representative shall preside over the first meeting at which a Chair and Vice-Chair shall be selected. Thereafter, the Chair, or in his or her absence, the Vice-Chair, shall schedule and preside over all meetings of the Governance Committee. During the pre-construction and construction phases of the Desalination Project, regular meetings of the Governance Committee shall be scheduled by the Chair, or in his or her absence, the Vice-Chair, and held on a monthly basis. During the operational phase of the Desalination Project, regular meetings of the Governance Committee shall be scheduled by the Chair, or in his or her absence, the Vice-Chair, and held on a quarterly basis for the first two years of the Desalination Project's operation and semi-annually thereafter. Special meetings of the Governance Committee, including for purposes of responding to a Cal-Am Notification, may be called by the Chair, or in his or her absence, the Vice-Chair, or by any member of the Governance Committee upon request of the Chair, or in his or her absence, the Vice-Chair.

B. Action by the Governance Committee. All decisions and recommendations of the Governance Committee issued to Cal-Am shall be in writing, signed by the Chair or Vice-Chair. All other actions of the Governance Committee shall be by motion recorded in written minutes.

C. Agendas, Correspondence, and Minutes. Agendas, correspondence, and minutes of the meetings of the Governance Committee shall be taken, maintained, and distributed by a designated staff member of the MPWMD.

VII. Quorum and Affirmative Action of the Governance Committee

To constitute a quorum at all meetings of the Governance Committee for the transaction of business, the primary or alternate elected official representative of at least three of the Parties must be present, in person. Action by the Governance Committee shall require the affirmative vote of at least two of the three Public Entity Members of the Governance Committee.

VIII. Submission of Project Information to the Governance Committee; Project Inspections

Concurrent with Cal-Am's submission of any documents concerning the Project to the CPUC, Cal-Am shall provide a copy of the documents (in paper or electronic form) to the Chair of the Governance Committee. The Chair may notice a meeting on his or her own initiative, or upon the request of any member of the Governance Committee, to review any financial matter addressed by the documents. Cal-Am, upon request of the Chair of the Governance Committee, shall be afforded an opportunity to provide a presentation or any oral explanation relating to the noticed financial matter. Further, upon reasonable advanced, written notice and subject to safety and security concerns and precautions as determined in good faith by Cal-Am, any member(s) of the Governance Committee may inspect any physical facility or structure constructed or being constructed as an element of the Desalination Project, and Cal-Am shall provide an employee, consultant, or other representative, who is knowledgeable of the aspects and elements of the physical facility or structure, to accompany the member(s) of the Governance Committee during the inspection.

IX. Term and Termination of Agreement

This Agreement shall continue in effect until the earlier of (1) the date that is forty (40) years after the effective date of this Agreement (March 8, 2053), or (2) the date that Cal-Am ceases to operate the Desalination Project, the earlier such date to be known as the "Expiration Date." Further, this Agreement may be terminated, prior to the Expiration Date, as follows: (1) by Cal-Am, following the issuance of an order from the CPUC ordering Cal-Am not to participate in this Agreement, as provided for in Section I above; (2) by Cal-Am, if the CPUC denies or rescinds Application A.12-04-019 or denies Cal-Am's development of, or subsequently rescinds Cal-Am's authority to develop, the Desalination Project; or (3) by the written agreement of no less than three of the four members of the Governance Committee. If, on September 8, 2052, the Desalination Project is still being operated by Cal-Am, the Parties shall, within thirty days thereafter, meet and commence negotiations in good faith to seek a renewal of this Agreement, upon mutually acceptable terms, to provide continued public oversight and input concerning the operation, maintenance, repair, modification, and/or replacement of the Desalination Project after the Expiration Date. If this Agreement is terminated by Cal-Am as a result of a CPUC order denying or rescinding Application A.12-04-019 or Cal-Am's authority to develop the Desalination Project, but Cal-Am intends to seek CPUC approval to develop a substitute project to provide water supplies for its Monterey District, then the Parties shall meet and negotiate in good faith to seek agreement, upon mutually acceptable terms, for a substitute agreement to provide public oversight and input concerning the design, permitting, construction, operation, maintenance, repair, modification, and/or replacement of such substitute project.

X. Miscellaneous

A. Further Assurances. The Parties shall execute such further documents and do any and all such further things as may be necessary to implement and carry out the intent of this Agreement.

B. Construction. The provisions of this Agreement shall be liberally construed to effectuate its purposes. The language of this Agreement shall be construed simply according to its plain meaning and shall not be construed for or against any Party, as each Party has participated in the drafting of this Agreement and had the opportunity to have their counsel review it.

C. Choice of Law. This Agreement shall be governed and construed under the laws of the State of California, with venue proper only in Monterey County.

D. Severability. If any term or provision of this Agreement is determined to be illegal, unenforceable, or invalid in whole or in part for any reason, such illegal, unenforceable, or invalid provision or part thereof, shall be stricken from this Agreement, and such provision shall not affect the legality, enforceability, or validity of the remainder of this Agreement. If any provision or part of this Agreement is stricken in accordance with the provisions of this section, then the stricken provision shall be replaced, to the extent possible and as agreed to by the Parties, with a legal, enforceable and valid provision that is as similar in content to the stricken provision as is legally possible.

E. Dispute Resolution. If a dispute arises between two or more of the Parties relating to this Agreement, or the rights and obligations arising therefrom, and if the Parties in dispute are unable to resolve the controversy through informal means, the Parties in dispute may, upon mutual agreement, submit the dispute to mediation, upon terms mutually agreed to by the Parties in dispute. Any Party not in dispute as to the disputed matter shall be afforded an opportunity to participate in the mediation. In addition, if the Parties in dispute are unable to resolve the controversy through mediation, the Parties in dispute may, upon mutual agreement, submit the dispute to binding arbitration, upon terms mutually agreed to by the Parties in dispute. Any Party not in dispute as to the disputed matter may, upon the mutual agreement of the Parties in dispute, be invited to participate in any binding arbitration.

F. Members to Bear their Own Costs. Each Party shall bear its own costs relating to the rights and obligations of each Party arising from this Agreement and its participation in the Governance

Committee and, therefore, no Party shall be entitled to any reimbursement from another Party as a result of any provision of this Agreement.

G. Notices and Communication. Any notice or communication hereunder shall be deemed sufficient if given by one Party to another Party or Parties, as appropriate, in writing and either (1) delivered in person, (2) transmitted by electronic mail and acknowledgment of receipt is made by the receiving Party(ies), (3) deposited in the United States mail in a sealed envelope, certified and with postage and postal charges prepaid, or (4) delivered by a nationally-recognized overnight delivery courier service, and addressed as follows:

If to Cal-Am:	California-American Water Company Attn: Robert MacLean President 1033 B Avenue, Suite 200 Coronado, CA 92118 Email: robert.maclean@amwater.com
with a copy to:	California-American Water Company Attn: Anthony Cerasuolo Vice President - Legal 1033 B Avenue, Suite 200 Coronado, CA 92118 Email: acerasuolo@amwater.com
If to the MPRWA:	Monterey Peninsula Regional Water Authority Attn: Lesley Milton Clerk City of Monterey 351 Madison St. Monterey, CA 93940 milton@monterey.org
with copies to:	Monterey Peninsula Regional Water Authority Attn: Donald Freeman General Counsel West Side of San Carlos & 8th P.O. Box 805 Carmel, CA 93921 cityatty@ix.netcom.com Monterey Peninsula Regional Water Authority Attn: Russell McGlothlin Special Counsel 21 E. Carrillo St., Santa Barbara, CA 93101 rmcglathlin@bhfs.com
If to the MPWMD:	Monterey Peninsula Water Management District Attn: David J. Stoldt General Manager 5 Harris Court – Bldg G Monterey, CA 93940 Email: dstoldt@mpwmd.net
with a copy to:	Monterey Peninsula Water Management District Attn: David C. Laredo

General Counsel
5 Harris Court – Bldg G
Monterey, CA 93940
dave@laredolaw.net

If to the County: County of Monterey Board of Supervisors
C/O Clerk of the Board of Supervisors
168 West Alisal Street
1st Floor
Salinas, CA, 93901
112-clerkoftheboardeveryone@co.monterey.ca.us

with a copy to: Monterey County Counsel
Attn: Charles J. McKee
168 West Alisal Street
3rd Floor
Salinas, CA 93901
mckeecj@co.monterey.ca.us

or to such other address or to such other person as each Party shall have last designated for receipt of notices pursuant to this Agreement. Where this Agreement provides for written notices or communication from Cal-Am to the Governance Committee, such written notice, explanation, or communication shall be directed to the Chair of the Governance Committee at the address set forth above for notices to the public entity from which the Chair is appointed, and when provided shall be deemed provided to all Public Entity Members of the Governance Committee. The effective date of any written notice, explanation, or communication shall be the earlier of the date of actual receipt, acknowledgment of receipt, or three days following deposit in the United States mail.

H. Successors and Assigns. This Agreement shall be binding on and shall inure to the benefit of the Parties and their respective legal representatives, successors, and assigns.

I. No Third Party Rights. Nothing in this Agreement, whether express or implied, is intended to confer any rights or remedies under or by reason of this Agreement on any persons other than the Parties to this Agreement and their respective successors and assigns, nor shall any provision in this Agreement give any third persons any right of subrogation or action over or against any Party to this Agreement.

J. Signatures - Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument. The Parties authorize each other to detach and combine original signature pages and consolidate them into a single identical original. Any of such completely executed counterparts shall be sufficient proof of this Agreement.

K. Effective Date. This Agreement shall take effect on date first stated above.

IN WITNESS WHEREOF, the Parties have executed this Agreement as of the date first stated above.

[signature page follows]

California-American Water Company

By: Robert MacLean
Robert MacLean,
President

Monterey Peninsula Regional Water Authority

By: _____
Chuck Della Sala
President

Agreed as to form:

By: _____
Donald Freeman
General Counsel

Monterey Peninsula Water Management District

By: _____
David Pendergrass
Chair

Agreed as to form:

By: _____
David Laredo
General Counsel

County of Monterey

By: Fernando Armenta
Fernando Armenta
Chair of the Board of Supervisors

Agreed as to form:

By: Charles McKee
Charles McKee
County Counsel

California-American Water Company

By: Robert MacLean
Robert MacLean,
President

Monterey Peninsula Regional Water Authority

By: Chuck Della Sala
Chuck Della Sala
President

Agreed as to form:

By: Donald Freeman
Donald Freeman
General Counsel

Monterey Peninsula Water Management District

By: _____
David Pendergrass
Chair

Agreed as to form:

By: _____
David Laredo
General Counsel

County of Monterey

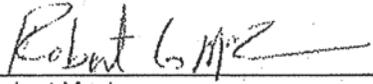
By: _____
Fernando Armenta
Chair of the Board of Supervisors

Agreed as to form:

By: _____
Charles McKee
County Counsel

Execution Copy – March 8, 2013

California-American Water Company

By: 
Robert MacLean,
President

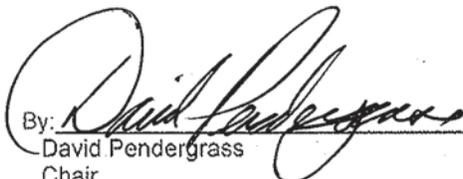
Monterey Peninsula Regional Water Authority

By: _____
Chuck Della Sala
President

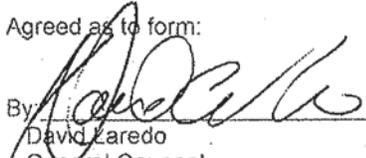
Agreed as to form:

By: _____
Donald Freeman
General Counsel

Monterey Peninsula Water Management District

By: 
David Pendergrass
Chair

Agreed as to form:

By: 
David Laredo
General Counsel

County of Monterey

By: _____
Fernando Armenta
Chair of the Board of Supervisors

Agreed as to form:

By: _____
Charles McKee
County Counsel

Appendix 2

**MPWSP - Confidential Settlement Discussions
Appendix 2**

	9.6 MGD			6.4 MGD		
	Low	Probable	High	Low	Probable	High
Plant Capital	265.2	312.0	378.2	229.0	269.4	324.9
AFUDC	<u>7.2</u>	<u>8.8</u>	<u>11.0</u>	<u>6.4</u>	<u>7.8</u>	<u>9.8</u>
Total Capital	272.4	320.8	389.2	235.4	277.2	334.7
Surcharge 2	<u>71.5</u>	<u>71.5</u>	<u>71.5</u>	<u>71.5</u>	<u>71.5</u>	<u>71.5</u>
Remaining Funding	200.9	249.3	317.7	163.9	205.7	263.2
CAW Equity	73.5	86.5	105.3	63.5	74.8	90.5
SRF Debt	65.2	76.8	93.4	56.4	66.4	80.2
Public Financing - 30Y	62.2	86.0	119.0	44.0	64.5	92.5
Yr 1 Cost to Customer	29.0	33.3	39.9	32.5	36.2	41.5
Yr 1 Rate Base	68.3	79.7	96.3	59.0	69.0	82.7
Debt % (pub fin not debt)	47%	47%	47%	47%	47%	47%
Debt % (pub fin is debt)	63%	65%	67%	61%	64%	66%
Equity % of Total Capital	27%	27%	27%	27%	27%	27%
1st Year RR + Base	86.7	91.0	97.6	90.2	93.9	99.2
Last Yr Base + Surcharge	92.1	92.1	92.1	92.1	92.1	92.1
% Change	(5.9%)	(1.3%)	5.9%	(2.1%)	1.9%	7.6%

Appendix 3

MPWSP - Confidential Settlement Discussions
Appendix 3

9.6 MGD Plant - Most Probable

	USES OF CASH					Total
	2013	2014	2015	2016	2017	
Desal Plant	0.2	26.1	16.1	109.6	65.0	217.0
CAW-Only Facilities	0.0	0.0	16.1	54.2	24.7	95.0
Carrying Costs	0.0	0.2	1.0	3.7	3.9	8.8
Total Uses of Cash	0.2	26.3	33.2	167.5	93.6	320.8
	SOURCES OF CASH					Total
	2013	2014	2015	2016	2017	
Net CAW Equity	0.0	7.1	9.0	45.2	25.3	86.6
Net SRF Debt	0.0	6.3	7.9	40.1	22.4	76.8
Surcharge 2	0.0	0.0	12.3	28.5	30.7	71.5
Public Agency Contrib	0.1	12.9	4.0	53.7	15.2	85.8
Total Sources of Cash	0.2	26.3	33.2	167.5	93.6	320.8

6.4 MGD Plant - Most Probable

	USES OF CASH					Total
	2013	2014	2015	2016	2017	
Desal Plant	0.2	25.4	15.6	83.7	49.6	174.4
CAW-Only Facilities	0.0	0.0	16.1	54.2	24.7	95.0
Carrying Costs	0.0	0.1	1.0	3.2	3.5	7.8
Total Uses of Cash	0.2	25.5	32.6	141.1	77.8	277.2
	SOURCES OF CASH					Total
	2013	2014	2015	2016	2017	
Net CAW Equity	0.0	6.9	8.8	38.1	21.0	74.8
Net SRF Debt	0.0	6.1	7.8	33.8	18.6	66.4
Surcharge 2	0.0	0.0	12.3	28.5	30.7	71.5
Public Agency Contrib	0.1	12.5	3.7	40.7	7.5	64.4
Total Sources of Cash	0.2	25.5	32.6	141.1	77.8	277.2