

ATTACHMENT 1

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

In the Matter of the Application of California-American Water Company (U 210 W) for a Certificate of Public Convenience and Necessity to Construct and Operate its Coastal Water Project to Resolve the Long-Term Water Supply Deficit in its Monterey District and to Recover All Present and Future Costs in Connection Therewith in Rates

Application No. 04-09-019

(Filed September 20, 2004, Amended
July 14, 2005)

**SETTLEMENT AGREEMENT BY AND AMONG CALIFORNIA-AMERICAN WATER
COMPANY, MARINA COAST WATER DISTRICT, MONTEREY COUNTY WATER
RESOURCES AGENCY, MONTEREY REGIONAL WATER POLLUTION CONTROL
AGENCY, PUBLIC TRUST ALLIANCE, AND SURFRIDER FOUNDATION**

Dated: April 6, 2010

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Pursuant to Article 12 of the Rules of Practice and Procedure of the California Public Utilities Commission ("Commission"), California-American Water Company ("CAW"), Marina Coast Water District ("MCWD"), Monterey County Water Resources Agency ("MCWRA"), Monterey Regional Water Pollution Control Agency ("MRWPCA"), Public Trust Alliance ("PTA"), and Surfrider Foundation ("Surfrider") (each individually, a "Party," and together collectively, the "Parties") consent to and agree to be bound by this Settlement Agreement.

RECITALS

A. CAW is a Class A investor-owned water utility regulated by the Commission. Its Monterey District serves most of the Monterey Peninsula, including Carmel-by-the-Sea, Del Rey Oaks, Monterey, Pacific Grove, Sand City, and Seaside, as well as the unincorporated areas of Carmel Highlands, Carmel Valley, Pebble Beach, and the Del Monte Forest.

B. CAW supplies its Monterey District with surface water and groundwater from the Carmel River System and the coastal subarea of the Seaside Groundwater Basin (also known as the "Seaside Basin"). CAW also operates three small independent water systems along the

Highway 68 corridor east of Monterey that draw water from the Laguna Seca subarea of the Seaside Basin.

C. CAW's Monterey District is adjacent to MCWD's Service Area and both are within MCWRA's jurisdictional boundaries.

D. Water supply in CAW's Monterey District has long been constrained due to frequent drought conditions on the semi-arid Monterey Peninsula, whose water supply is highly dependent upon rainfall. In addition, diversions in excess of safe yield from the Salinas and Seaside Basins have caused seawater intrusion that has been recognized for decades.

E. CAW has owned and operated the San Clemente Dam and the Los Padres Dam since 1965. The San Clemente Dam was constructed on the Carmel River in 1921 and is the major point of surface water diversion from the Carmel River. The Los Padres Dam was constructed in 1951. Sedimentation has reduced the usable storage at both reservoirs over the years, such that by 1995, the primary source of water supply for CAW was multiple wells located along the Carmel River. These wells supplied approximately 70 percent of CAW's Monterey District demand, with the balance of supply provided by storage at the Los Padres Reservoir, diversions from the San Clemente reservoir, and water pumped from the Seaside Basin. CAW's main distribution system also includes eight wells in the Coastal subarea of the Seaside Basin. In addition, CAW owns nine wells in the Laguna Seca subarea, which serve the three independent water systems along Highway 68 described above.

F. As of 1995, CAW served approximately 105,000 customers in its Monterey District, supplying them with approximately 17,000 acre-feet of water per year (afy). Of this amount, approximately 14,106 afy was supplied from the Carmel River system and 2,700 afy was supplied from the Seaside Basin.

G. In 1995, the State Water Resources Control Board ("SWRCB") issued its Order No. WR 95-10 ("Order 95-10"). The SWRCB concluded that although CAW had been diverting 14,106 afy from the Carmel River, it has a legal right to divert only 3,376 afy from the Carmel River system, including surface water and water pumped from the Carmel Valley wells. Thus, SWRCB ordered CAW to replace what SWRCB determined to be unlawful diversions of 10,730 afy from the Carmel River with other sources and through other actions, such as conservation to offset demand. Order 95-10 also concluded that CAW's unpermitted diversions damage the riparian and aquatic habitat of the Carmel River and the species that inhabit them.

H. On July 27, 2009, the SWRCB issued a Draft Cease-and-Desist Order that proposed to order CAW to undertake additional measures. After considering written comments and public testimony, the SWRCB issued a revised Draft Cease-and-Desist Order on September 16, 2009 and its final Cease-and-Desist Order on October 20, 2009 (Order No. WR 2009-0060) (the "CDO"), which requires CAW to undertake additional measures to reduce its unpermitted diversions from the Carmel River and to terminate all diversions in excess of 3,376 afy no later than December 31, 2016. The CDO is presently stayed by court order.

I. On September 20, 2004, CAW filed the instant application with the Commission, Application No. 04-09-019 (the "Application"), seeking approval from the Commission of a

water supply project that would provide a long-term water supply solution for the water supply deficit in its Monterey District and the grant of a certificate of public convenience and necessity (“CPCN”) authorizing the construction and operation of the project. CAW amended the Application on July 14, 2005, and the Application remains pending before the Commission. The Commission proceeding initiated by the Application is referred to as the “Proceeding.”

J. All Parties to this Settlement Agreement are active parties in the Proceeding.

K. On September 6, 2005, the assigned Administrative Law Judge (“ALJ”) in the Proceeding determined that there should be two distinct phases to the Proceeding. In Phase 1, which was intended to address interim rate relief, the Commission issued D.06-12-040, which authorized CAW to implement the Special Request 1 Surcharge to collect authorized pre-construction costs and Special Request 2 Surcharge to collect revenues through customer contributions to offset the cost of the approved long-term supply project.

L. On January 30, 2009, the Commission, acting as Lead Agency under the California Environmental Quality Act (“CEQA”), issued a Draft Environmental Impact Report (“DEIR,” State Clearinghouse No. 200610104) analyzing the potential environmental impacts of a project designated the “Coastal Water Project” and alternatives to it. The Commission duly received and analyzed extensive public comment on the DEIR. MCWD, MCWRA, and CAW and other parties to this Settlement Agreement provided comments on the DEIR.

M. On March 13, 2009, a prehearing conference was held, initiating Phase 2 of the Proceeding, and the Assigned Commissioner’s and ALJ’s Joint Scoping Memo Ruling was issued on March 26, 2009. Facilitated cost workshops were held on July 7th and 8th, 2009, and public participation hearings were held in Monterey and Seaside on July 13th and July 14th, respectively. The schedule set forth in the Scoping Memo Ruling was subsequently revised by ALJ Ruling on July 21, 2009, and again on August 10, 2009, in response to MCWD’s motion to address the environmental review documents in a decision separate from the decision addressing the remainder of the CPCN issues. Because issuance of the Final Environmental Impact Report was delayed by 30 days, the schedule was again revised on September 14, 2009.

N. On October 30, 2009, CAW, MCWD, and MCWRA jointly filed and served a motion requesting that the procedural schedule be held in abeyance to afford the parties additional time to conduct settlement discussions. The Parties filed and served responses on November 4, 2009. On November 6, 2009, the ALJ issued a ruling that extended the procedural schedule, required the parties to participate in alternative dispute resolution (“ADR”), required CAW to convene a settlement conference by year-end 2009, required CAW to provide joint status reports on a biweekly basis, and scheduled a formal status conference for January 4, 2010.

O. In the Proceeding, CAW, MCWD and MCWRA, first by themselves and later joined in the ADR process by numerous other parties to the Proceeding, have continuously worked cooperatively to reach settlement of the many difficult issues inherent in developing a water supply project that is vital to CAW, CAW customers, the Carmel River riparian and aquatic habitat and the various species therein, MCWD, MCWD customers, MCWRA, MCWRA

ratepayers, the Seaside Basin and the Monterey region as a whole.

P. On December 17, 2009, in Decision (“D.”) 09-12-017, which was issued in the proceeding, the Commission, as Lead Agency, after considering all relevant environmental documents, duly certified the FEIR. The FEIR described and studied three alternative projects which are being considered for approval by the Commission in the proceeding – the Moss Landing Project, the North Marina Project, and a third alternative project variously referred to as the “Regional Alternative” and the “Regional Project” and “Phase I of the Regional Project.” The principal element of that third alternative project is a regional desalination water supply project, with other smaller elements.

Q. On April 5, 2010, MCWD, and on April 6, 2010, MCWRA, each acting as a Responsible Agency under CEQA, and having fully considered all relevant environmental documents, including the FEIR, approved the regional desalination project that is described in the Water Purchase Agreement (“WPA”), which is attached hereto as Attachment 1, subject to Commission approval. That project is referred to as the “Regional Desalination Project.”

R. The Parties to this Settlement Agreement, subject to the Approval Condition Precedent hereinafter discussed, have agreed to the development of the Regional Desalination Project. The Regional Desalination Project will consist of three primary elements. MCWRA will own, install, operate, and maintain wells through which brackish source water will be extracted and transported to a desalination plant. MCWD will own, construct and operate the desalination plant and transport desalinated Product Water to a delivery point, where some of the Product Water will be received by CAW and some will be received by MCWD. MCWD will utilize the Product Water delivered to it for its existing customers, and in the future may utilize some of the Product Water to serve customers in the former Ford Ord. CAW will distribute its portion of the Product Water through facilities it owns for which the Commission should grant a CPCN. Operations of all project facilities shall be conducted so that all Legal Requirements are met, including but not limited to the requirements of the Agency Act-, the SWRCB Order 95-10 and the CDO. Greater detail regarding the design, construction, and operation of the Regional Desalination Project is found in two agreements, the WPA and the Outfall Agreement (together referred to as the “Implementing Agreements”) discussed in Article 7 of this Settlement Agreement. Greater detail regarding the cost and ratemaking treatment of the Regional Desalination Project and the facilities that CAW will own in connection with the Regional Desalination Project is contained in this Settlement Agreement and the Attachments hereto.

S. The Parties to this Settlement Agreement believe that the Regional Desalination Project provides the most expeditious, feasible, cost-effective and best alternative to satisfy the needs of MCWD’s and CAW’s Monterey District customers as described in the FEIR while also considering and balancing the regional water supply and environmental concerns referenced in Recital O above.

T. The Parties to this Settlement Agreement believe that among the alternative water supply projects pending before the Commission in the Proceeding, the Regional Desalination Project (i) addresses the water supply constraints in Monterey County in a way that best serves (a) community values, (b) recreational and park areas, (c) historical and aesthetic values, and (d) influence on the environment, (ii) is by far the least costly and the most environmentally benign,

(iii) is the most and perhaps only feasible project alternative, and (iv) best conserves and protects public trust assets, resources and values impacted by providing a water supply.

U. The Parties to this Settlement Agreement also believe that time is of the essence in implementing the Regional Desalination Project for the following reasons:

- The currently stayed CDO requires CAW to reduce its diversions from the Carmel Valley Aquifer in increasing amounts from 10,209 acre feet in water year 2009-10 to 3,376 acre feet in water year 2016-17 and requires a moratorium on all new water connections in CAW's Monterey District.
- There are opportunities that may be lost if the Regional Desalination Project is delayed, such as obtaining tax-exempt private activity bonds and/or low-interest State Revolving Fund financing allocated for 2010 and various grants that may be budgeted for 2010.
- There is currently a favorable construction climate in California.

V. The Parties to this Settlement Agreement believe that the development, construction, and operation of the Regional Desalination Project does and will serve the present and future public convenience and necessity, and that the Commission should grant CAW a CPCN to construct and operate the distribution pipeline and aquifer storage and recovery facilities portion of the Regional Desalination Project that CAW proposes to own (referred to as the "CAW Facilities").

W. The Parties acknowledge the legal requirement that CAW customers be charged rates that are just and reasonable. In light of that acknowledgement, with respect to the ratemaking treatment for the CAW Facilities set forth in Article 9 of this Settlement Agreement, the cost recovery mechanism set forth in Article 9 represents an effort to strike a balance between minimizing costs of the CAW Facilities and assuring CAW ratepayers only pay for actual necessary expended capital investment. The semi-annual recovery of capital investment in CAW Facilities outlined in Article 9 serves the goal of minimizing rate impacts on customers by placing the costs of the CAW facilities in rates on an after-the-fact periodic basis, and reducing the amount of carrying costs that are capitalized; facilitating timely construction and capital investment in the most efficient manner possible; and working to ensure that CAW's financial well-being is not impaired through minimization of the cash-flow impact of the large capital investment required by the CAW Facilities. ~~In addition, this ratemaking treatment poses no danger of over-recovery by CAW because only prudent costs will be recovered through rates in the manner set forth in Article 9.~~

~~X. The participation of MCWD and MCWRA in the Regional Desalination Project creates numerous benefits to the customers and ratepayers of CAW and to the general public including but not limited to the following: the opportunity to reduce capital costs by obtaining federal and state grant funding; low interest State Revolving Fund loan financing and tax exempt private activity bond financing; a means by which the Regional Desalination Project can comply~~

~~with the Agency Act and the ordinances of Monterey County; expeditious access to a site on which the Regional Desalination Project may be constructed at lower costs than other alternatives; facilitation of the most environmentally benign alternative; potential benefits to the Carmel River riparian and aquatic habitat and species therein; ongoing efforts to prevent and reduce seawater intrusion to the Salinas Basin; and broad political and popular support.~~

Y. The Parties desire to avoid the expense, inconvenience and uncertainty inherent in litigating the matters in dispute between them in the Proceeding and to reach a resolution of as many of the issues in the Proceeding as possible, thus bringing a water supply solution to Monterey County that best serves the public convenience and necessity.

AGREEMENT

In consideration of the mutual covenants set forth in this Settlement Agreement and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties hereby agree as follows:

1. Definitions. All initially capitalized terms not defined in this Settlement Agreement shall be given the same meaning as used in the WPA attached to the Settlement Agreement as Attachment 1.

2. Compromise; No Admission of Liability. This Settlement Agreement represents a compromise by the Parties that is intended to, and does, resolve the issues in the Proceeding identified herein. The Parties have entered into each stipulation and term contained in this Settlement Agreement and, where applicable to a Party, the accompanying Implementing Agreements, on the basis that submission of the Settlement Agreement to and/or approval and authorization of the Settlement Agreement 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. Furthermore, the Parties understand that this Settlement Agreement and any approval of it by the Commission is subject to Rule 12.5 of the Commission's Rules of Practice and Procedure, and intend that the submission and/or approval and authorization of this Settlement Agreement by the Commission not be construed as a precedent or statement of policy of any kind for or against any Party in any current or future proceeding.

3. Integrated Package. This Settlement Agreement is being presented as an integrated package such that the Parties are agreeing to the Settlement Agreement as a whole, as opposed to agreeing to specific elements of the Settlement Agreement. If the Commission approves the Settlement Agreement or any Implementing Agreement with modifications, the procedures in Article 6 shall apply.

4. Motion for Approval. The Parties shall cooperate fully in the timely preparation and filing of a joint motion for approval of this Settlement Agreement, requesting that the Commission approve and adopt this Settlement Agreement, the Implementing Agreements and all their respective terms and conditions without change, and find that this Settlement Agreement and the Implementing Agreements are reasonable, consistent with applicable law and in the public interest. The Parties agree actively to support and to use their best efforts to obtain Commission approval of this Settlement Agreement.

5. Recognition Assessment of Financial Impacts of Settlement on CAW. The Parties acknowledge that the WPA attached to this Settlement Agreement commits a significant amount of CAW's future cash flows to funding the debt service that MCWD and MCWRA will incur to build the Regional Desalination Project. ~~The accounting treatment of this commitment of future cash flows may be determined to be either, but not limited to, a capital lease, which would have a significant impact on the amount of debt and capital assets CAW records on its financials with potential negative impacts on CAW's debt ratios, or a bulk water purchase agreement that would have a negative impact on the credit rating of CAW, as determined by rating agencies. Additional analysis of the appropriate accounting treatment and financial impact, if any, of this commitment will be required.~~ The Parties acknowledge the financial well-being of CAW is essential to the ability of MCWD and MCWRA to issue bonds. ~~The Parties therefore agree that the Commission should take steps to ensure CAW's financial well-being in a subsequent proceeding. Such proceeding shall only be initiated once CAW determines after appropriate analysis the accounting treatment for its commitment under the WPA.~~

6. Commission Modification.

6.1 If the Commission approves the settlement subject to modification of this Settlement Agreement or any Implementing Agreement, the Parties request the Commission to provide a reasonable period for the Parties to consider and respond to such modification.

6.2 If the Commission approves the settlement subject to modification of the Settlement Agreement, 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. 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 CAW, MCWD or MCWRA – each of whom will own a portion of the project – are 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 CAW, MCWD or MCWRA, the settlement and this Settlement Agreement shall be void and this Proceeding will return to a litigation track on a schedule to be established by the Commission.

6.3 If the Commission approves the settlement subject to modification of one or more Implementing Agreements, then, no later than two business days before the deadline imposed by the Commission for acceptance of the modification, the required Parties to the pertinent Implementing Agreement (as identified in the pertinent portion of ~~this Article 67~~) must either approve the modification in their sole discretion or, in response to the Commission-required modification, the required Parties may propose a different or related changes to the pertinent Implementing Agreement and if they arrive at agreed-upon alternative changes to such Implementing Agreement, they may request the Commission to accept such alternative changes. If the Commission proposed modification of an Implementing Agreement is not consented to by the required Parties or they have proposed alternative changes in response thereto which the

Commission does not accept, the settlement and this Settlement Agreement shall be void and this Proceeding will return to a litigation track on a schedule to be established by the Commission.

6.4 As used herein below, the “Approval Condition Precedent” refers to the Commission’s (i) approval of this Settlement Agreement, the Implementing Agreements and all their respective terms and conditions (a) without change or (b) if any changes in this Settlement Agreement are required by the Commission as a condition to such approval, then either all such changes have been consented to by the Parties or at least CAW, MCWD and MCWRA have consented to such changes and have requested the Commission to approve the Settlement Agreement in the absence of the agreement of the Party or Parties who decline to accept the Commission’s modification and the Commission gives its approval, and/or (c) if any changes in the Implementing Agreements are required by the Commission as a condition to such approval, then all such changes have been consented to by the required parties to those Implementing Agreements or alternative changes have been proposed by such parties and the Commission accepts the alternative changes, and (ii) finding that, subject to any such changes, this Settlement Agreement and the Implementing Agreements are reasonable, consistent with applicable law and in the public interest.

7. Implementing Agreements. The Parties request approval of this Settlement Agreement as well as two related Implementing Agreements.

7.1 Following is a brief description of each of the Implementing Agreements.

7.1.1 Water Purchase Agreement. The WPA will be by and among required parties CAW, MCWD and MCWRA, and a copy of the WPA is attached to this Settlement Agreement as Attachment 1. The WPA will provide CAW’s Monterey District and its ratepayers a reliable long-term water supply. Among other subjects, the WPA addresses the rights, obligations and duties of MCWD, MCWRA and CAW with respect to the design, construction and permitting of the elements of the Regional Desalination Project described generally in Recital R above.

7.1.2 Outfall Agreement. The Outfall Agreement will be by and between required parties MCWD and MRWPCA, and a copy is attached to this Settlement Agreement as Attachment 2. The Outfall Agreement commits sufficient capacity in the MRWPCA Outfall to MCWD to discharge the reject process water (“Brine”) from the desalination plant. The Outfall Agreement provides for a one-time capacity charge based upon the current value of the Outfall and the percentage of total Outfall capacity required to discharge the Brine. Brine discharge from the MCWD Facilities has priority over all users other than MRWPCA.

7.2 In the absence of a Commission statement to the contrary, approval of this Settlement Agreement shall be deemed to constitute approval of all the terms and conditions of the Implementing Agreements.

7.3 The Parties agree that no Party assumes any liability under the Implementing Agreements solely by reason of such Party entering into the Implementing Agreements and this Settlement Agreement; provided, however, that upon satisfaction of the

Approval Condition Precedent and, assuming the conditions precedent set forth in the applicable Implementing Agreements have been satisfied, the Implementing Agreements shall be immediately effective.

8. CAW Facilities. The Parties agree to the following terms relating to the cost of the CAW Facilities.

8.1 A description of the CAW Facilities, the construction schedule for those facilities, and the costs of those facilities are as follows:

8.1.1 The CAW Facilities that are the subject of this Settlement Agreement consist of three large diameter conveyance pipelines (total of 57,000 lineal feet), two distribution storage reservoirs (three million gallons each) and aquifer storage and recovery (ASR) facilities. These facilities include: 1) the Transfer Pipeline; 2) the Seaside Pipeline; 3) the Monterey Pipeline (including Valley Greens Pump Station); 4) the Terminal Reservoirs; and 5) the ASR facilities. The cost estimate for these facilities is addressed in Section 8.1.3 and Attachment 3 and Attachment 4 to this Settlement Agreement.

8.1.2 A detailed description and construction schedule for the CAW Facilities is provided in Attachment 3 to this Settlement Agreement. The schedule is an estimate and is contingent upon the timely issuance of a CPCN. The general schedule has land/right-of-way acquisition, permitting, preliminary design and detailed design for the facilities commencing as early as the fourth quarter of 2010, and being completed by the middle of 2012. The general schedule has construction for the facilities commencing as early as the fourth quarter of 2011, and being completed by the summer of 2014.

8.1.3 Cost Estimate-Cap. The Parties agree to a range of target cost estimates for the CAW Facilities. These target cost estimates are identified as the Low Scenario; the Median Scenario; and the High Scenario in Attachments 3 and 4. ~~The Low Scenario is estimated at \$82,610,000; the Median Scenario is estimated at \$95,000,000; and the High Scenario is estimated at \$118,750,000.~~¹ For ease of reference, the Low Scenario represents a target cost estimate that is approximately 15 percent below the Median Scenario target cost estimate. Similarly, the High Scenario represents a target cost estimate that is 25 percent above the Median Scenario target cost estimate. The low, medium and high scenarios for the CAW Facilities can be found in Attachment 4 to this Settlement Agreement. The Parties agree that for purposes of setting an estimated cost cap for the facilities the mid-point of the medium and high scenarios, or 106,875,000, most probable capital cost for each of the five capital projects should be used for each individual capital project and the most probable total

¹ The range of target cost estimates cited in this Section has been based on Class 4 estimates using the Association for the Advancement of Cost Engineering International ("AAACEI") classification categories. AAACEI defines the Class 4 estimate at the level of project development of a "study or feasibility" which signifies a comparatively low level of project development such as completion of only 1% to 15% of project definition. The +/- value or "low" and "high" scenarios represent the expected accuracy range of the cost estimate, the typical percentage variation of actual costs from the cost estimate.

cost of the five capital projects combined of \$70,000,000 should be used for the overall total project cost of the CAW Facilities ("the Cap").²

8.1.4 Used and Useful Determination of Facilities. Certain of the CAW Facilities were designed to resolve two critical operational limitations of CAW's existing distribution system: 1) the inability to maintain adequate water levels in the Forest Lake Tanks during maximum day demand conditions (usually several hot summer days in sequence); and 2) the inability to move water from the Seaside area to the rest of the Monterey Peninsula. The Parties agree that, except for the Transfer Pipeline, the CAW Facilities, ~~should be treated for ratemaking purposes as used and useful even if~~ status of CAW Facilities be considered independent of the status of the Regional Desalination Project is delayed for some reason, including but not limited to delays caused by construction or permitting, for ratemaking purposes.

8.1.5 Cost Containment. The Parties agree to the following cost containment and project management measures:

8.1.5.1 ~~establishing~~ Establishing clear and measurable goals and objectives;

8.1.5.2 ~~setting~~ Setting design criteria that meet these goals and objectives;

8.1.5.3 ~~freezing~~ Freezing the project size and configuration as early as possible in order to avoid the possibility of scope creep;

8.1.5.4 ~~employ~~ Employing a transparent and systematic program of review to ensure that the design conforms to established and accepted design criteria and design configuration; and

8.1.5.5 ~~using~~ Using Value Engineering in order to reduce costs, as set forth in Section 4.3(c) of the WPA. The Parties agree that all costs related to Value Engineering on the CAW Facilities will be charged to these facilities and allowed for ratemaking purposes as a part of the cost thereof.

8.1.5.6 Reducing the project cost contingencies as project cost estimates evolve towards full project definition and maturity. Following the AACS definitions, the parties will reduce contingencies to a range of 10-15% at the time the parties have a Class 2 control or bid tender estimate and reduce the project cost contingencies to 5% at the stage the parties have a Class 1 bid/tender or check estimate.

8.1.5.7 Modifying the overall total capital project cost ("the Cap") based on the actions specified in Section 8.1.5.6.

² Reference DRA Testimony, page 2-11

8.1.5.8 Reporting the progress of capital projects to DRA staff, consistent with Section III.B. of the Partial Settlement Agreement between the Division of Ratepayer Advocates and the California American Water Company on Issues Presented in the General Rate Case in A.09-01-013 dated December 18, 2009.

8.1.5.9 Seeking additional Commission Authorization for spending, if necessary. Submitting a separate Application committing to Commission reasonableness review and authorization of costs in the event that any of the following events occur: a) expenditures are forecasted to exceed the estimated cost cap established in Article 8.1.3; b) the project scope is modified from that authorized by the Commission in the CPCN.

9. Ratemaking Treatment for CAW Facilities.

9.1 Revenue Requirement Components. CAW shall use the following components in its calculation of the projected and actual revenue requirement associated with this project, until such time that all approved costs of the CAW Facilities are in rate base in utility plant in service and made part of base rates in the next scheduled general rate case:

9.1.1 Utility Plant in Service (UPIS). The total cost of the projects outlined above subject to the Cap and Allowance for Funds Used During Construction (AFUDC), including, but not limited to, all applicable pre-construction costs and accumulated AFUDC, that are completed and used to provide service to customers, regardless of the source of funds. The Transfer Pipeline will not be considered UPIS before the Regional Desalination Project is completed and delivering Product Water to Cal Am customers.

9.1.2 Construction Work in Progress (CWIP). The total cost of the projects outlined above subject to the Cap and AFUDC, including, but not limited to all applicable pre-construction costs and accumulated AFUDC, that are not currently providing service to customers, regardless of the source of funds.

9.1.3 Rate Base. The sum of UPIS and CWIP less any grant funds received specific to the projects outlined above and less any accumulated depreciation.

9.1.4 Non Rate Base Investment. The difference between i) the total cost of the projects outlined above including, but not limited to, all pre-construction costs and AFUDC, and ii) the combination of a) the amounts that are deemed to be included in Rate Base and b) any grant funds received.

9.1.5 Costs for Debt and Other Non-Equity Sources. The weighted average embedded interest rate of CAW's actual debt issuances which were issued to fund the projects outlined in the Settlement Agreement, including financing costs. The debt used to finance these facilities should not be included in weighted average cost of capital for other facilities of CAW. The interest rate for State Revolving Funds will be based on the embedded cost of the issuance.

9.1.6 Authorized Return on Equity Rate. CAW will use its authorized return on equity rate, as may be adjusted from time to time by decision from this Commission. The authorized ROE for 2010 is 10.20%.

9.1.7 Equity Used. ~~The difference between i) the sum of a) rate base, b) non rate base investment, and c) accumulated depreciation and ii) the total debt and other non-equity sources of funds raised specifically to fund the projects listed above~~CAW will use equity amounts that adhere to its authorized capital structure, as may be adjusted from time to time by decision from this Commission. CAW's current authorized equity percentage is 42%.

9.1.8 Federal Income Tax Rate. CAW will use its authorized federal income tax rate, as may be adjusted from time to time by decision from this Commission. CAW's current authorized federal income tax rate is 35%.

9.1.9 State Income Tax Rate. CAW will use its authorized state income tax rates, as may be adjusted from time to time by decision from this Commission. CAW's current authorized state income tax rate is 7.69%. Depreciation, ad valorem taxes and uncollectibles will be considered a part of determining the state income tax rate.

9.1.10 Combined Effective Income Tax Rate. The combined effective income tax rate will be calculated using the following formula:

$$1 - [(1 - \text{state income tax rate}) \times (1 - \text{federal income tax rate})]$$

9.1.11 Pre-Tax Cost of Capital. The pre tax weighted average cost of capital used to fund the projects listed above. This will be calculated by the following formula: $\{[(\text{Equity Used} \times \text{Authorized Return on Equity Rate}) / (1 - \text{Combined Effective Income Tax Rate})] + [(\text{Rate Base} + \text{Non Rate Base Investment} + \text{Accumulated Depreciation}) - \text{Equity Used}] \times \text{Costs for Debt and Other Non-Equity Sources}\}$ divided by $\{\text{Rate Base} + \text{Non Rate Base Investment} + \text{Accumulated Depreciation}\}$

9.1.12 AFUDC Amount. The product of the ~~Pre-Tax Cost of Capital~~AFUDC Percentage and the Non Rate Base Investment. Such amount will be calculated monthly and will become an additional amount to be added to the Non Rate Base Investment.

9.1.13 AFUDC Percentage. CAW will use the following formula to reflect the discounting of the annual rate for monthly compounding:

$$\text{AFUDC Percentage} = \left[\left(1 + A/100 \right)^{1/12} - 1 \right] \times 100$$

Where A = one-year borrowing cost of 2.46%

9.1.14 Depreciation Rates. CAW will use its authorized depreciation rates by asset type, as may be adjusted from time to time by decision from this Commission. For purposes of this mechanism, CAW's current applicable annual rates for the expected categories of UPIS are:

Wells	3.14%
Supply Mains	1.80%
Pump Stations	4.27%
Reservoirs	1.83%

Distribution Mains 1.63%

9.1.15 Ad Valorem Tax Rate. CAW will use the ad valorem tax rate from its most recent general rate case in which the Commission has issued its final decision. CAW's current applicable rate for 2010 and 2011 based on the previous Commission decision is 1.355%.

9.1.16 Uncollectible Revenues Percent. CAW will use the uncollectible revenue percent from its most recent general rate case in which the Commission has issued its final decision. CAW's current applicable rate is 0.2643%.

9.2 Revenue Requirement Calculation. CAW's revenue requirement associated with this project shall be the sum of:

9.2.1 Rate Base multiplied by Pre-Tax Cost of Capital

9.2.2 UPIS by asset class multiplied by the appropriate Depreciation Rate by asset class

9.2.3 Rate Base, net of accumulated depreciation for ratemaking purposes, multiplied by the Ad Valorem Tax Rate

9.2.4 The difference between a) the sum of 9.2.1, 9.2.2, and 9.2.3 above, divided by the difference between 1 and the Uncollectible Revenues Percent and b) the sum of 9.2.1, 9.2.2, and 9.2.3 above

9.3 Revenue Requirement Calculation and Reporting Process. The Commission should authorize CAW on a ~~semi~~-annual basis to include all prudently expended costs related to the construction of the CAW Facilities into rate base as either CWIP or UPIS, and therewith earn a return on and recovery of these costs in base rates.

9.3.1 CAW will file advice letters ~~on a semi~~-that conform to the requirements of General Rules 7.3.3, 7.3.3 (8)³, and 7.6.2 of General Order 96-B on an annual basis on ~~May 15 and November 15~~ to allow all project expenditures through ~~April 30 and October 31~~ (respectively) into rate base and base rates as of ~~July 1 (May 15 filing) and January 1 (November 15 filing)~~ (following year).

9.3.2 The ~~semi~~-annual revenue calculation shall be cumulative for this project and continue to adjust base rates until such time as the entire project is closed to UPIS and all approved project costs are in base rate calculations. The CWIP balance for any ~~semi~~-

³ General Rule 7.3.3 (8) of General Order 96(b) which was authorized by Resolution W-4749, states:

"Rate base offset except that a Rate base offset will be disposed of under Tier 2 when staff determines that:

(i) The Rate base offset was previously approved by the Commission in a decision or resolution;

(ii) The project scope is consistent with what the Commission approved; and

(iii) The Commission approval included a budget cap and the rate base offset request is at or below the budget cap.

annual advice letter filing will be the difference between total accumulated project spend, including AFUDC, and the total project spend, including AFUDC, that is proposed to be included in UPIS in the subject advice letter filing. Rate base for the purposes of the semi-annual filing will be the prior authorized rate base in the previous advice letter filing, plus the additional proposed UPIS and CWIP, less accumulated authorized depreciation for the UPIS.

9.3.3 All project costs will continue to earn AFUDC until such time as allowed in rate base. Proposed incremental CWIP and UPIS in each advice letter will include estimated AFUDC for the period between the expenditure cut off date (~~April 30 and October 31~~) and the effective date of the advice letter (~~July 1 or January 1~~).

9.4 Annual Revenue Requirement Determination in the Advice Letter. CAW may file advice letters to incorporate the annual project spend into rate base on ~~May 15 and November 15~~ of each year. Base rates shall be adjusted proportionately through the current rate design model. The advice letters will support all spend with invoices, journal entries or other support.

9.4.1 Such advice letters shall be processed by the Commission within ~~30 days to ensure that~~ using the timeframes specified in General Order 96(B) for the rate increase resulting from the advice letter is effective as of ~~July 1 (May 15 filing), or January 1~~ of the following year (November 15 filing).

9.4.2 If the advice letter is not processed and cannot be made effective ~~on July 1 or by January 1~~ of the following year, the revenue requirement as filed by CAW shall be implemented subject to ~~true~~ refund.

9.4.3 In the year all projects are completed, CAW may file the advice letter as soon as possible and it will be processed with ~~60 days using the timeframes specified in~~ General Order 96(B). This final advice letter will place the full return on and the recovery of all plant investment, including prudently incurred costs over the Cap, into rate base and base revenue requirement and rates, contingent on reasonableness review. This advice letter filing procedure will terminate when all plant additions have been completed and after all such additions have been authorized as part of base rates.

9.5 Determination of Asset Retirements. For ratemaking purposes, assets that will no longer be deemed used and useful for the provision of service to customers will be retired in the ordinary course of business. The retirements will be forecast along with the general rate case to be filed in May 2013, and will be anticipated to be made in 2015. Since retirements made in the ordinary course of business do not impact rate base, there will be no impact on the revenue requirement except for reductions in depreciation and ad valorem taxes. Depreciation accrual rates will also be adjusted in the next general rate case to reflect these retirements.

~~9.6~~ Rate Design Determination. ~~CAW shall utilize its current rate model Pursuant to determine the scoping ruling for this proceeding, the Parties agree that rate design.~~

~~9.6.1 Under the current rate design model, the block one residential rate does not change, and therefore the entire revenue requirement for this project will~~ shall be

~~placed on only residential customers who exceed the water use allowed addressed in Block 1 and placed on all usage of non-residential customers.~~

9.5.1 ~~This advice letter determined revenue requirement will not be applied to customers in Toro, Ambler Park, Chualar or Ralph Lane, unless and until such time as water from the Regional Desalination Project is able to be delivered to them a separate phase of this proceeding.~~

9.6 Special Request 2 Surcharge. The Parties recommend that the Commission discontinue the Special Request 2 Surcharge as defined in D.06-12-040 “to generate revenues to offset the ultimate cost of a long-term water supply, whether it is the Coastal Water Project or an alternative” until the project comes online.

10. CAW Cost Recovery and Ratemaking of Product Water Costs.

~~10.1 All Agency Costs Reasonable and Prudent. The Parties agree that, given the status of MCWD and MCWRA as governmental agencies and the requirements under law that they incur only reasonable and prudent costs and expenses for purposes related to their governmental duties and the fact that such costs and expenses are subject to public review and scrutiny, all Regional Desalination Project costs incurred by MCWD and MCWRA in compliance with the terms of the WPA shall be deemed reasonable and prudent and the Commission, by its approval of this Settlement Agreement, shall be deemed to have agreed that such costs are reasonable and prudent.~~

Recovery of Costs Through Cost of Product Water. MCWD’s and MCWRA’s costs of constructing and operating the portions of the Regional Desalination Project that are owned by them are included in the cost of Product Water under the WPA. ~~CAW will also incur costs to perform its obligations under the terms of the WPA and, to the extent not reimbursed to CAW from MCWD or MCWRA from the proceeds of the bond debt used to fund the construction of the MCWD Owned Facilities or the MCWRA Owned Facilities or previously recovered by CAW from ratepayers through existing Commission approved, and capped at \$2200 per acre foot in 2015, escalated in years after 2015 at the inflation rate recovery, those costs are intended to be included in the cost of Product Water under the WPA. Such costs generally consist of, but are not limited to, the costs of arranging and documenting the financing of Replacements not covered by the Reserve Fund Account or Replacement Indebtedness, the cost of negotiating and preparing any amendments to the WPA and obtaining any necessary approvals, certain costs of insurance, the cost of the CAW letter of credit required under the WPA, the cost of taxes (if any) with respect to any taxable interest CAW may have in the MCWD Owned Facilities and/or the MCWRA Owned Facilities by virtue of the WPA, costs of the escrow that will be used to distribute product water payments, and defense costs, including attorneys fees, relating to claims challenging the approval of the Regional Desalination Project. By its approval of this Settlement Agreement, the Commission will be deemed to have agreed that (i) MCWD’s and MCWRA’s costs included in the cost of Product Water pursuant to the terms of the WPA are reasonable and prudent, (ii) to the extent not previously recovered by CAW from ratepayers through existing Commission approved rate recovery, the CAW costs and payments included in the price of~~

~~Product Water or otherwise incurred by CAW pursuant to the terms of the WPA are reasonable and prudent, and (iii) CAW is authorized to recover in the cost of the Product Water any other costs incurred by CAW pursuant to the terms of the WPA that are not recovered by CAW from ratepayers through existing Commission rate recovery as published in the Global Insight U.S. Economic Outlook monthly publication.⁴ If necessary, CAW shall request adjustment of the cost cap in an application with the CPUC and shall justify and provide supporting documentation for all costs, both above and below the Commission Authorized Cost Cap in its application.~~

~~10.2—Recovery of Product Water Payments from Ratepayers. Under the WPA, the cost of Product Water will have two components: (i) the debt service associated with financing capitalized costs of designing, permitting, constructing and otherwise associated with completing the MCWD Owned Facilities and the MCWRA Owned Facilities, and (ii) the costs of operating the MCWD Owned Facilities and the MCWRA Owned Facilities and the CAW costs described in Section 9.2 above. By its approval of this Settlement Agreement, the Commission authorizes CAW to recover from its ratepayers the cost of the Product Water received under the WPA through rates by means of the authorized Modified Cost Balancing Account (“MBCA”). Because the costs of the operational component of the price of the Product Water described in clause (ii) above will vary from time to time and the portion of the amortization of capital costs included in the price of Product Water taken by CAW may vary from time to time, the cost of Product Water under the WPA will vary from month to month. As a party to the WPA, CAW will be informed of the actual price of Product Water and the future estimated cost of Product Water. By its approval of this Settlement Agreement, the Commission authorizes CAW in its discretion to file Tier 1 advice letters to adjust customer rates as needed to match the actual cost of Product Water under the WPA so as to ensure that customer rates remain aligned with the actual cost of Product Water under the WPA.~~

10.1 Ratemaking Treatment of Costs attributable to CAW through the WPA.

10.1.1 The WPA commits CAW to a long-term arrangement to purchase water. The agreement contains substantial costs for which the customers of the Monterey District will be responsible. The Parties recognize that there is a need to ensure that all reasonable, prudently incurred and CPUC authorized costs attributable to CAW through the WPA are paid by CAW and, in turn, by its customers.

~~10.3.2—The Parties agree that the same ratemaking mechanism currently employed for purchased water costs (a Modified Cost Balancing Account (MCBA)) will continue to be employed in the Monterey District, and that WPA costs will be a part thereof.~~

~~10.4—CAW Loans. The WPA provides that CAW will be obligated to make loans to MCWD and/or MCWRA under the limited circumstances described in the WPA. By its approval of this Settlement Agreement, the Commission is deemed to have authorized those loans and found them to be reasonable and prudent and further to have found that the method and terms of repayment of those loans as particularly described in the WPA are reasonable and prudent and, if for any reason, those loans are not recovered in the price of the Product Water, then the principal amount thereof and interest thereon shall be recovered in CAW's rates.~~

⁴ These annualized escalation factors are summarized by DRA's Energy Cost of Services Branch in a monthly memorandum that is available to utilities.

10.2 Rate Impact Mitigation. The Parties recognize the Regional Desalination Project will result in a significant rate impact, and therefore recommend that the Commission expand the eligibility for qualification of customers for CAW's low income ratepayer assistance program and adopt more progressive rate design.

~~10.6 Substantial Contribution. The Parties agree that intervenor Surfrider has made a substantial contribution to this Proceeding, including but not limited to provision of a full economic analysis of the alternative projects and contributing to the Parties' understanding of the risks and benefits of the alternative projects. The Parties further agree that intervenor PTA has made a substantial contribution to this Proceeding in areas vital to public health and safety, and that upon the filing of an appropriate request for relief by PTA, the Commission should exercise its authority to modify the Administrative Law Judge's Ruling Denying Eligibility For Intervenor Compensation For Public Trust Alliance And Affirming Eligibility Of Surfrider Foundation issued on May 29, 2009 to find PTA eligible for intervenor compensation.~~

11. Headings. Headings in this Settlement Agreement are included for reference only and are not intended nor shall they be taken or claimed to affect the meaning of the contents or the scope of this Settlement Agreement.

12. Modification Only In Writing. As between the Parties, this Settlement Agreement may be amended or modified only by a written agreement by the Parties.

13. Counterparts. 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.

14. Authorization. Each Party hereto covenants and warrants that execution of this Settlement Agreement has been authorized by its respective governing body and that the person executing the Settlement Agreement has been authorized to do so.

[SIGNATURE PAGE TO FOLLOW]

IN WITNESS WHEREOF, each of the Parties hereto have each caused this Settlement Agreement to be duly executed and delivered in their name and on their behalf, respectively, as of the day and year first written above.

MARINA COAST WATER DISTRICT:

By: _____
Name: Kenneth Nishi
Title: President

CALIFORNIA-AMERICAN WATER COMPANY:

By: _____
Name: Robert G. MacLean
Title: President

PUBLIC TRUST ALLIANCE:

By: _____
Name: Michael Warburton
Title: Executive Director

MONTEREY COUNTY WATER RESOURCES AGENCY:

By: _____
Name: Curtis V. Weeks
Title: General Manager

MONTEREY REGIONAL WATER POLLUTION CONTROL AGENCY:

By: _____
Name: Louis R. Calcagno
Title: Board Chair

SURFRIDER FOUNDATION:

By: _____
Name: Jim Moriarty
Title: Chief Executive Officer

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Attachments to Settlement Agreement

Attachment 1: Water Purchase Agreement

Attachment 2: Outfall Agreement

Attachment 3: Description of CAW Facilities, Construction Schedule, and Costs

Attachment 4: CAW Facilities: Conceptual Capital Cost Estimates – Project Cashflow under Low, Medium and High Scenarios