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A LEADERSHIP VOICE TO ADDRESS THE PRESSING NEED OF ENSURING THE REGION CONTINUES TO HAVE A SAFE, SUSTAINABLE, AND RELIABLE WATER SUPPLY

October 1, 2012

Robert MacLean
President
California American Water
1033 B Ave., Suite 200
Coronado, CA 92118

RE: CPUC Application 12-04-019

Subj: Proposal by the Monterey Peninsula Regional Water Authority and the County of Monterey for Public Participation in the Governance and Financing of the Desalination Component of the Monterey Peninsula Water Supply Project

Dear Mr. MacLean:

This letter, which is submitted jointly by the Monterey Peninsula Regional Water Authority ("Authority") and the County of Monterey ("County"), sets forth proposals, made in collaboration with the Monterey Peninsula Water Management District ("District"), for public participation respecting the governance and financing of the desalination component ("Project") of the California American Water Company's ("Cal-Am") proposed Monterey Peninsula Water Supply Project ("MPWSP"). This proposal is responsive to Section 3.2.1 of the ruling issued in the above-referenced proceeding by Administrative Law Judge Weatherford on August 29, 2012 titled "Administrative Law Judge's Directives to Applicant and Ruling on Motions Concerning Scope, Schedule and Official Notice." Section 3.2.1 of that ruling, provides in part, ". . . Cal-Am should be open to and seriously consider in good faith any public agency proposal for direct participation in the MPWSP made to it no later than October 1, 2012."

The governance and financing proposals set forth below are premised on an assumption (not presently endorsed by the Authority) that the CPUC adopts a Certificate of Public Convenience and Necessity ("CPCN") that authorizes Cal-Am to construct the proposed Project. The Authority has not yet determined whether it will support Cal-Am's proposed Project or one of two proposed alternative desalination projects: the People's Moss Landing Water Desal Project and DeepWater Desal's Moss Landing Project. The Authority has retained the consulting engineering firm, Separation Processes, Inc. ("SPI"), to review the proposed Project in comparison to the alternative projects to determine which project is most likely to be completed in a timely and cost-effective manner. Once SPI issues its final report to the Authority, which is expected by the end of October, the Authority will then determine which of the three projects it intends to support within the CPUC proceeding. The Authority and the County intend to request that should the CPUC issue a CPCN authorizing construction of the Project, that the CPCN also include provisions pertaining to Project governance and financing that are generally consistent with the proposals set forth below.

We also note that the County and District support public ownership of the Project. The Authority has not taken a position on the ownership issue, and the proposals set forth in this letter are limited to the matters of governance and financing of the Project.

PROJECT GOVERNANCE

Basis for Public Participation in Project Governance

Assuming that the CPUC adopts a CPCN that authorizes construction of the Project, then the Authority and the County propose that the Authority, the District, and the County join with Cal-Am to develop a governance committee to review, advise, and decide Project determinations that will significantly affect the public interest. This governance framework is intended to provide meaningful public participation in four key areas of public concern: (i) transparent accountability and reporting of Project activities to the public; (ii) decision-making authority over certain selected key issues; (iii) collaboration between Cal-Am and the public entities on several important topics; and (iv) the need for coordinated water supply operations.

Public participation in the governance of the Project, as proposed below, will allow for input regarding critical Project decisions that occur after the issuance of a CPCN for the Project that will significantly affect the public interest. This will allow participation by elected officials that are directly accountable to the public that will be supplied with water from the Project. One example is the decision concerning the sizing of the Project when a decision is made whether to include the proposed Groundwater Replenishment program, sponsored by the Monterey Regional Water Pollution Control Authority ("MRWPCA"), within the MPWSP. By creating a means for public participation in these post-CPCN Project decisions there will be an acceptable mechanism for public input and accountability for these critical decisions, which will, in turn, mitigate public concerns and yield greater public support for the Project.

Governance Proposal

To this end, the Authority and the County recommend the formation of a "Governance Committee" that would be comprised of the three public entities (i.e., the Authority, the District, and the County) and Cal-Am. Each of the public entities will be represented on the Governance Committee by one elected member and one designated staff member from each respective public entity. Each of the public entities and Cal-Am, except in the situations identified below, will have an equal voting weight in decision-making.

The function of the Governance Committee shall be to: (i) in consultation with and assistance from Cal-Am and the design-build firm selected for the Project, provide a means to coordinate the design, permitting, construction, operations, maintenance, repairs, and replacements of the components of the Project; (ii) serve as the entity which Cal-Am regularly updates as to Project status and issues; and (iii) consult with and provide advice to Cal-Am in connection with the Project. The members of the Governance Committee shall diligently consider all matters and cause the Governance Committee to timely and promptly make recommendations before it.

Three categories of issues/decisions/topics have been identified that may be addressed by the Governance Committee in the following manner:

Category A: The three public-entity members of the Governance Committee make the decision after receipt of a written recommendation from Cal-Am.

Category B: The three public-entity members of the Governance Committee share the decision-making role with Cal-Am (equal votes of each of the three public entities and Cal-Am). However, Cal-Am may exercise a veto right and override the Governance Committee's Recommendation, provided that it first provides a detailed written explanation of its intent to exercise its veto right and provides for a ten (10)-day review and comment period to receive

comments from the Governance Committee.

Category C: Cal-Am makes the decision after receiving advice from the Governance Committee. Cal-Am need not issue a written explanation for its decision, although should Cal-Am not follow the advice of the Governance Committee, then it may need to answer to the CPUC at Cal-Am's next rate case.

For all categories, the Governance Committee should be given a specified timeframe in which to make any decisions or provide any advice; otherwise Cal-Am may make the subject decision without advice or decision, as applicable, by the Governance Committee. This provision will avoid undue delay to the Project's development and operation.

The Authority and the County recommend that the following key Project decisions be distributed among the three categories as follows:

Category A: Public Entity Members of the Governance Committee Make the Decision after Receipt of a Written Recommendation from Cal-Am

1) Determine the "Go/No Go" decision with respect to the Groundwater Replenishment Project, in conjunction with the MRWPCA, which would own and operate the Groundwater Replenishment Project;

2) Select the Certified Value Engineer (to perform value engineering for the Project);

3) Review and determine whether to adopt any value engineering recommendations issued by the Value Engineer;

4) Approve any major change order over $1 million;

5) Issue decisions concerning Project aesthetics consistent with community values if the decision would not cause the Project construction costs to exceed the CPUC approved budget; and

6) Issue decisions concerning procurement of alternative (non-PG&E) energy supplies for the Project, including waste-to-energy.

In addition to the decisions for determination by the public-entity members of the Governance Committee in Category A, the public-entity members would also have the right to request inspection of facilities upon reasonable advanced notice, and to perform reasonable audits of Cal-Am's financial records at Cal-Am's offices in Monterey County relating to the Project.

Category B: Governance Committee Shares Decision-Making with Cal-Am Equally. However Cal-Am May Exercise a Veto Right and Override the Recommendation of the Governance Committee Provided that it First Provides a Detailed Written Explanation and Opportunity for Comment by the Government Committee

1) Establish qualifications and selection criteria for design and engineering contractors;

2) Review and evaluate proposals from qualified contractors;

3) Participate in the selection of the design and engineering professionals, including without limitation the award of the design-build contract;

4) Review and issue determinations concerning material changes at key stages of the design process, including:

- Basis of Design
- 30% Design
- 60% Design
- Value Engineering
- 90% Design, and
- Final Design

5) Establish a community outreach program, including a plan and budget for community outreach to be included within the CPCN;

6) Determine Project aesthetics consistent with community values, if not within the CPUC approved budget;

7) Coordinate with Cal-Am with respect to resolution of issues concerning the use of the MRWPCA's ocean outfall; and

8) Review and issue determinations concerning the award of pipeline contracts in each jurisdiction.

Category C: Cal-Am Makes Decision After Advice from the Governance Committee (No Written Explanation Required for Deviation from Governance Committee Recommendation)

1) Monitor the design, engineering, and permitting of all elements of the Project on a quarterly basis;

2) Review contract terms, including financial contracts, to be included in all major contracts, both construction and service, for the Project;

3) Preparation and quarterly update of an overall construction budget for the Project;

4) Review and acceptance of a detailed plan for acceptance testing, including follow-up reporting;

5) Annually review the Project operations and maintenance budget and rate impacts; and

6) Coordinate with Cal-Am with respect to local and regional permit requirements.

The Authority and the County also propose that a separate "Operations Committee" be created, which would be comprised of Cal-Am, the District, the Authority, the County, and the Seaside Basin Watermaster, to coordinate planning and operation of the various water supply projects, especially as they relate to the use of the Seaside Groundwater Basin for storage and recovery of water from the basin.

PROJECT FINANCING

Assuming that the CPUC adopts a CPCN that authorizes construction of the Project, then the Authority and the County support the District's offer to be the "public partner" for financial issues. In this role, the District would make the commitments and potential decisions set forth below. The Authority and the County intend to request that the CPUC's CPCN direct Cal-Am to accept the District's decision

regarding these financing alternatives at the time that Project financing is obtained if doing so would reduce costs to Cal-Am's ratepayers. The Authority and the County recognize that financing decisions must not operate in a manner that would compromise the Project's feasibility or unreasonably delay its construction. Therefore, provisions must be included in any agreement pertaining to Project financing to resolve any disputes concerning the District's Project financing proposals as they relate to Project feasibility and timing. We believe an acceptable resolution of this issue may be developed pursuant to further discussions and refinement of the financing proposal.

Potential Project financing matters for direction by the District include the following:

1) If available, State Revolving Fund ("SRF") loans should be maximized and considered for up to 100% of the Project funding to reduce costs to Peninsula ratepayers;

2) If SRF loans are not available for the entire Project, then the District may require Cal-Am to examine tax-exempt "private activity" debt as a funding source for both debt and equity;

3) If the acquisition of SRF loans requires the participation of a public entity, as is normally the case, the District should serve in that role.

4) The District may propose that a public agency (e.g., the District) contribute public funds in lieu of Cal-Am debt or equity to reduce costs to Peninsula ratepayers. The contribution would be made via public debt and the source of repayment would be from either a surcharge on the Cal-Am bill or direct fees and charges to property owners in the District established following compliance with Proposition 218 requirements; and

5) Even in the event that Cal-Am does incur debt for the Project, the District may propose to substitute its public credit as a "backstop" to Cal-Am's creditworthiness in order to reduce the Project's cost of capital. This might require the use of a "stand-by water purchase agreement," a "rate covenant," and other standing commitments.

NEXT STEPS

The proposals set forth above provide a general outline of a potentially acceptable governance framework and financing approach for Cal-Am's proposed Project if the Cal-Am Project is approved by the CPUC. We encourage Cal-Am to collaborate with the Authority, the District, and the County, to refine the specific parameters of these proposals to be included in a mutually supported agreement to be presented for consideration by the CPUC if the CPUC approves the Project. Further, the District is presently refining possible Project financing options, some of which are anticipated to be completed this year. Accordingly, the financial proposals set forth above may be modified and refined consistent with the District's pending analysis.

The Authority and the County are willing to continue to meet informally with Cal-Am and the District, and are also is willing to participate in mediated settlement discussions respecting these proposals if Cal-Am believes such settlement discussions would be helpful to reach an agreement on these matters. We welcome your input in this respect.

Thank you for your prior participation in meetings with us concerning these issues. We look forward to further collaboration with Cal-Am with respect to this proceeding.

Sincerely,

Chuck Della Sala
President, Monterey Peninsula Regional Water Authority

David Potter
Monterey County 5th District Supervisor

Cc: Russell M. McGlothlin, Brownstein Farber Hyatt, L.P.
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