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**BEFORE THE PUBLIC UTILITIES COMMISSION**

**OF THE STATE OF CALIFORNIA**

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| 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<br>(Filed April 23, 2012) |

# CALIFORNIA-AMERICAN WATER COMPANY COMPLIANCE PROGRESS REPORT FILING


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October 26, 2012

**BEFORE THE PUBLIC UTILITIES COMMISSION**

**OF THE STATE OF CALIFORNIA**

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| 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<br>(Filed April 23, 2012) |

**CALIFORNIA-AMERICAN WATER COMPANY**
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## I. INTRODUCTION

Pursuant to the *Administrative Law Judge's Directives to Applicant and Ruling on Motions Concerning Scope, Schedule and Official Notice* ("Ruling"),[1] California-American Water Company ("California American Water") hereby submits this compliance filing providing a status report of its deliberations on the various public agency proposals submitted on October 1, 2012.

The Monterey Peninsula Regional Water Authority and County of Monterey ("Regional Water Authority"); Monterey Peninsula Water Management District ("MPWMD"); the City of Pacific Grove ("City"); and the City and Moss Landing Commercial Park, LLC (referred to as the "People's Project"),[2] each submitted on October 1, 2012 a proposal for direct public agency participation in the Monterey Peninsula Water Supply Project ("MPWSP"). Consistent with the assigned Administrative Law Judge's ("ALJ") directive, California American Water reports on its efforts to consider "any public agency proposal for participation in the Monterey Peninsula Water Supply Project (MPWSP) that is feasible and sufficiently developed to allow

[1] *Administrative Law Judge's Directives To Applicant And Ruling On Motions Concerning Scope, Schedule And Official Notice*, August 29, 2012, Ordering Paragraph No. 3.

[2] The City of Pacific Grove submitted proposals for two types of projects: three small water recycling projects not requiring desalination within the City of Pacific Grove, and a desalination project at Moss Landing entitled, the "People's Project".

implementation in a timely manner and that is made by October 1, 2012."[3] California American Water has met with the respective agencies to discuss their proposals and provides its responses below.

## II. MONTEREY PENINSULA REGIONAL WATER AUTHORITY AND COUNTY OF MONTEREY PROPOSAL

California American Water received the Regional Water Authority's proposal on October 1, 2012, regarding public participation in the governance of the desalination component of the MPWSP. On October 2, 2012, the Regional Water Authority submitted a financing proposal for the MPWSP.

### A. The Proposal

The Regional Water Authority recommends forming a "Governance Committee" comprised of the Regional Water Authority, California American Water, and certain other Monterey County public entities, provided that the Commission adopts a Certificate of Public Convenience and Necessity authorizing California American Water to construct the MPWSP. The public entities would each elect one member and one designated staff member for the Governance Committee, and the entities would be involved in the decision-making.

The Regional Water Authority proposes that the Governance Committee would coordinate various aspects of the design, permitting, construction, operations, maintenance, repairs, and replacements of the project components. California American Water would regularly provide the Committee updates as to MPWSP status and issues, and the Committee would consult with and provide advice to California American Water for the MPWSP.

The Regional Water Authority proposes that the Committee address three categories of issues, in the following ways.

First, the Committee would have ***sole decision-making authority*** after receiving a written recommendation from California American Water on "Category A" issues, including the determination of whether to proceed with the Groundwater Replenishment Project. The

[3] Ruling, p. 16.

Regional Water Authority also proposes that it have sole decision-making authority on the selection of a Certified Value Engineer, value engineering recommendations, change orders over $1 million, project aesthetics, and procurement of alternative energy supplies.

Second, the Regional Water Authority would ***share decision-making authority*** with California American Water on "Category B" issues, which include the selection and proposals from design-build contractors and engineers, project design changes, community outreach programs, change orders over $1 million, and use of the MRWPCA's ocean outfall. California American Water could veto and override the Governance Committee's recommendation, if it provides a detailed written explanation of its intent to exercise its veto right and provides for a ten-day review and comment period to receive comments from the Governance Committee.

Third, California American Water would make decisions after receiving advice from the Governance Committee on "Category C" issues, which include the project design, engineering and permitting, contract terms, budget and rate impacts. Under this scenario, California American Water would not issue a written explanation for its decision, but should California American Water not follow the advice of the Governance Committee, it would have the ability to address the issue in California American Water's next general rate case.

**B. Progress Report**

California American Water appreciates the cooperative nature of the Regional Water Authority's proposal, but it cannot support public ownership for the desalination component of the MPWSP.[4] Despite various claims, there is no credible evidence that public ownership would result in either lower rates or enable the project to be delivered more expeditiously. As evidenced in the MPWSP application and supporting testimony, California American Water supports the groundwater replenishment component of the MPWSP being publicly owned. Additionally, MPWMD owns two Aquifer Storage and Recovery wells used for storing excess Carmel River flows for summer usage.

[4] The Regional Water Authority has not weighed in on this issue, but MPWMD and the County of Monterey have discussed it with California American Water.

California American Water has met with the Regional Water Authority on multiple occasions to discuss its governance proposal, and during that process has acknowledged support for many of the governance concepts in the Regional Water Authority's proposal. However, California American Water does not wish to entertain the Regional Water Authority's proposal if the Regional Water Authority is actively working to support an alternative project. Such an outcome would not be in the interest of customers, as it could delay implementation of the MPWSP and compliance with the State Water Resources Control Board ("SWRCB") Cease and Desist Order. California American Water would seek approval of the governance role from this Commission and concurrence from the SWRCB prior to any agreement with the Regional Water Authority.

California American Water recently provided its written feedback to the Regional Water Authority representatives on the proposal. These edits and comments, attached hereto as **Attachment 1**, are general in nature and additional discussion is required to further define each party's position before California American Water could reach an agreement with the Regional Water Authority and other parties as to the structure and function of the Governance Committee. Moreover, the Regional Water Authority's proposal is conditioned upon its acceptance of the MPWSP as the selected project in the proceeding before the Commission. Likewise, California American Water's response is also conditioned to only apply if the Regional Water Authority finds the MPWSP the best alternative to solve the Peninsula's water needs.

California American Water will continue discussions with the Regional Water Authority to identify the proper entities for a governance role with the project. California American Water is aware that issues relating to the membership of the Governance Committee (*i.e.*, dual roles of the Board members) have recently arisen and been discussed at the meeting with the Regional Water Authority. Such issues may be resolved through the Regional Water Authority's request for an Attorney General Opinion regarding membership in the Regional Water Authority.

In sum, California American Water supports many of the governance concepts offered by the Regional Water Authority and will continue to support the collaborative effort with the

Regional Water Authority.

## III. MPWMD PROPOSAL

MPWMD submitted a financing proposal on October 2, 2012, which California American Water addresses below.[5] MPWMD has also been actively involved in discussions with California American Water, the Regional Water Authority and the County of Monterey on the non-finance aspects of project governance. That is not addressed here as it is discussed in Section II above.

### A. The Proposal

The MPWMD proposal recommends using State Revolving Fund ("SRF") loans for up to 100% of the project funding. Otherwise, it proposes that California American Water use tax-exempt "private activity" debt as a funding source for debt and preferably in lieu of equity.[6] MPWMD proposes that California American Water consider an MPWMD contribution in lieu of California American Water debt or equity, "to reduce costs to peninsula ratepayers."[7] If California American Water needs to borrow funding, MPWMD would offer its potential public credit "backstop." MPWMD believes that this would "enhance" California American Water's credit worthiness and reduce the cost of California American Water's debt.[8] For permanent financing, MPWMD believes that the Commission should require consideration of future market conditions and the proposed public participation in financing.

### B. Progress Report

California American Water has met with and discussed the financing proposal with MPWMD. Indeed, California American Water's application already contains some of the financing concepts proposed by MPWMD. As described below in more detail, if SRF funds are not available, California American Water would consider tax-exempt debt for financing. Similarly, California American Water proposes implementing Surcharge 2 to fund $99.1 million

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[5] On October 1, 2012, California American Water received a letter proposal from MPWMD nearly identical to the Regional Water Authority's proposal on governance of the MPWSP. *See* MPWMD Proposal, pp. 1-4.
[6] MPWMD Proposal (Appendix A), pp. 4-5.
[7] MPWMD Financing Proposal, p. 2.
[8] MPWMD Financing Proposal, p. 2.

of the MPWSP construction. In contrast, the MPWMD proposal would limit California American Water's equity investment and add significant risk to equity holders, which compromises the utility's financial integrity.

Similar to the MPWMD (and Regional Water Authority's) financing proposal, California American Water's financing plan already relies on SRF loans to fund the MPWSP. For the reasons described below, California American Water cannot support a proposal that limits equity financing to less than the current authorized level.[9]

California American Water maintains its position that California American Water customers will derive a number of benefits from the financing plan proposed in A.12-04-019:

First, California American Water has agreed to provide up to $20 million in short term financing for use during the 3.5 year construction period to reduce AFUDC. This is because the short-term debt rate, estimated at 1.0% over the 3.5 year construction period, is well below long-term rates. The use of short-term debt allows California American Water to put off financing through long-term debt and equity.

Second, California American Water has requested that the approval granted in D.06-12-040 be honored as it was intended in that decision—to provide for a surcharge to mitigate the rate impact of the water supply solution. Surcharge 2 will collect $99.1 million through a memorandum account and directly offset costs during construction. This will reduce the total project cost by accounting for the surcharge collection as a reduction to costs. Surcharge 2 will reduce the amount of the plant that needs to be financed.

Third, California American Water proposes to utilize SRF financing as the source of long-term financing for the project. The SRF financing rate of 2.5% is based on the average historical interest rate charged by the SWRCB since the beginning of 2008. This rate is significantly below long-term debt rates and reduces the overall financing costs to customers.

Fourth, California American Water's proposal to finance construction through the use of Surcharge 2 and SRF would allow this portion of the investment to be excluded from property

[9] *See* D.12-07-009, p. 2, Table I.

tax assessment. This is supported by the tax regulations and discussions with the State Board of Equalization. Assuming $99.1 million of the total project cost of the plant is funded through Surcharge 2 and assuming a property tax rate of 1.05%, the first year annual savings would total $1.0 million. The first year annual savings related to the portion funded with SRF financing would range from $0.6 to $0.8 million depending upon the project size and costs of construction.

Fifth, if SRF financing is not available, California American Water has proposed employing long-term debt at the then-current market rate. The modeling assumes a rate of 5.0% if California American Water is required to obtain long-term debt for the project. California American Water would likely obtain this financing from American Water Capital Corporation. The 5.0% rate is significantly below the current authorized cost of debt of 6.63%.

Sixth, California American Water is in the process of applying for SRF financing for the MPWSP. However, it is also applying for SRF financing for the long-term debt component of the MPWSP. The testimony in A.12-04-019 estimates the first year revenue requirement savings between SRF and the current authorized cost of debt of $2.3 million or a 16.7% reduction.

California American Water's application provides a multi-pronged approach that includes desalination, ground water replenishment and aquifer storage and recovery as a balanced solution. In the same way, the financing plan is a balanced proposal that provides significant benefits to customers, while preserving the financial integrity of the utility. The financing plan, with its specific contingencies, also recognizes the objective for construction to be completed in time to meet the SWRCB December 2016 deadline. While California American Water supports considering differing approaches and suggestions, they must be evaluated within the context of their impact on customers and the utility, and how they would impact the project schedule.

To that end, California American Water provides the following comments on the MPWMD financing proposal:

| MPWMD Consideration | CALIFORNIA AMERICAN WATER Response |
|---|---|
| 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. | California American Water's financing plan relies on SRF loans to fund the long-term debt portion of the utility investment. California American Water cannot support MPWMD's proposal that limits equity financing to less than 53%, which is California American Water's current authorized equity ratio from its most recent Cost Of Capital decision (D.12-07-009).[10]<br><br>Financing 100% with debt is not possible without imparting significant financial harm and risk on equity holders as a result of this project.<br><br>Without equity infusion, California American Water could be out of compliance with its current indenture requirements. |
| 2. If SRF loans are not available for the entire project, then require Cal-Am to examine tax-exempt "private activity" debt as a funding source for both the debt component, but preferably additionally in lieu of equity. | If SRF funds are not available, California American Water will examine the taxable and tax-exempt debt markets at the time of financing. If tax-exempt bonds carry a lower interest rate, California American Water will issue tax exempt debt to the extent it is available. California American Water cannot support a proposal that limits equity financing to less than its current authorized level.<br>See response 1 above for indenture requirement and risk issues. |

[10] *See* D.12-07-009, p. 2, Table I.

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| 3. Consider a public agency (i.e. MPWMD) contribution 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 either a surcharge on the Cal-Am bill or direct fees and charges to property owners in the District established with a Proposition 218 process. | California American Water has proposed implementation of Surcharge 2 to fund $99.1 million of the project construction. Depending upon the plant size, this represents between 37% and 45% of the total MPWSP investment. California American Water financing plan is a balanced proposal that provides significant benefits to customers, while preserving the financial integrity of the utility. The MPWMD proposal would limit California American Water's equity investment and add significant risk to equity holders. California American Water has agreed to further discuss this issue with MPWMD. |
| 4. Even in the event of a Cal-Am borrowing, the District should offer and the CPUC should accept the District's potential public credit "backstop" to enhance the Cal-Am borrowing credit rating and reduce costs to Peninsula ratepayers. The District offers to substitute its public credit as a backstop to Cal-Am's credit worthiness in order to reduce the cost of Cal-Am's debt. It is anticipated that Cal-Am's parent obligation carries a credit rating of Baa2, but the District could raise that to perhaps A1. This might require the use of a "stand-by water purchase agreement," a "rate covenant," and other standing commitments. | American Water Treasurer, Bill Rogers, California American Water President, Rob MacLean, California American Water Vice-President of Finance, Jeff Linam and MPWMD General Manager David Stoldt met at California American Water's offices on September 26th and discussed the District's backstop proposal. California American Water believes that more discussion is needed to determine whether this proposal would provide benefits to customers. Further, Moody's and Standard & Poor's recently changed the outlook of American Water Capital Corporation debt to positive. |
| 5. In all cases, the CPUC should require – at that point in the future when permanent financing is considered – that the then-current market conditions be considered and, if warranted, the public participation in financing as outlined above be required. | California American Water has proposed that in the case of SRF or long term debt , financing should be based on the current market conditions.<br><br>The Commission cannot speculate on future conditions. The Commission should only be obligated to review in future proceedings the actions taken by California American Water and not hold control over future actions. |

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| 6. If it turns out that State Revolving Funds require a public partner, as it normally would in most cases, the District offers to serve in that role. | If required, California American Water would consider an appropriate public partner. |

## IV. SMALL WATER PROJECTS PROPOSAL

On October 1, 2012, the City filed a proposal for three small projects within Pacific Grove that would reduce potable water demands to its golf course, cemetery, and other nearby landscaping by approximately 500 acre feet per year. The City indicates that the cost of water from two of the three projects would be less expensive than California American Water's proposed MPWSP. The three projects proposed by the City are the Pacific Grove Satellite Recycled Water Treatment Project, the Pacific Grove Recycled Water Project, and Pacific Grove Storm Water Recycling Project.[11]

California American Water has carefully reviewed the three small projects and has met on several occasions with the City of Pacific Grove to discuss the projects, to gain a better understanding of their needs, goals and expectations. The meetings between the City and California American Water demonstrated a strong collaborative effort by both parties. California American Water supports the proposed projects as they are consistent with the State's goals to efficiently reuse wastewater for irrigation demands in lieu of potable water.

California American Water agrees with the City of Pacific Grove that the Recycled Water Project will improve water quality in the Monterey Bay and provide a new source of water to the Peninsula. However, the size of the three projects are very small compared to California American Water's water supply requirements. Accordingly, California American Water cannot likely reduce the size or capital costs of the MPWSP, even if these projects were implemented on a timely basis.

Notably, California American Water does not have infinite resources and must focus first and foremost on the MPWSP, and therefore does not wish to take the lead any of the proposals as outlined currently. However, California American Water will continue to assist the City to

[11] City of Pacific Grove Small Projects Proposal, p.1.

advance the projects and is open to considering other potential arrangements for public-private participations in these projects. California American Water finds that the estimated costs for the Pacific Grove Satellite Recycled Water Treatment Project and the Pacific Grove Recycled Water Project appear to be feasible, but will need time for further review and analysis to verify the proposal's assumptions and data.

In addition, California American Water and the City have discussed possible applications for grants in their meetings. Both parties agree that they will need to conduct further investigation into the viability of such financing options.

## V. THE "PEOPLE'S PROJECT"

The "People's Project" is a proposed desalination plant located in Moss Landing, which has been under development since 2004. The City of Pacific Grove has agreed to become the lead public agency and proposes that California American Water partner with the City on the project. Under the proposal, California American Water would be responsible for sale of water to consumers, construction of necessary water delivery pipelines, and operation of the desalination plant.[12]

California American Water has reviewed the proposal for the People's Project. On October 9, 2012, California American Water served a data request on the City of Pacific Grove, and on October 19, 2012, California American Water received a response to the data request. California American Water is currently evaluating the People's Project proposal in light of that of information, and will determine next steps.

## VI. CONCLUSION

Consistent with the Ruling, California American Water has received and considered the proposals for participation in the MPWSP from the Regional Water Authority, MPWMD, the City, and the "People's Project". The proposals are under discussion between the parties, and California American Water continues to work with the parties to consider public agency participation in the MPWSP.

[12] City of Pacific Grove proposal cover letter, p. 2.

Notably, California American Water's application already includes a multi-pronged approach that includes desalination, ground water replenishment and aquifer storage and recovery as a balanced solution that includes public participation in two of the three components. The Commission must balance the desired public agency participation with the required completion of MPWSP by December, 2016. While California American Water will consider differing approaches and suggestions from the public agencies, California American Water respectfully urges the Commission to consider them within the context of their impact on California American Water's customers and the project schedule.

October 26, 2012

Respectfully submitted,

By: */s/ Sarah E. Leeper*
Sarah E. Leeper

Attorney for Applicant
California-American Water Company

# Attachment 1

MONTEREY PENINSULA REGIONAL WATER AUTHORITY
580 PACIFIC STREET
MONTEREY, CA 93940

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

**California American Water mark-up draft – 10/25/12**

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**

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, and Project commissioning, (ii) to consult with Cal-Am post-commissioning as to maintenance, repairs, and replacements of the components of the Project; (iii) serve as the entity which Cal-Am regularly updates as to Project status and issues; and (iv) 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 seven (7)-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 choose to not follow the advice of the Governance Committee, then any party may raise the issue for CPUC review during Cal-Am's next general rate case.

For all categories and for all items within each category, the Governance Committee should be given a specified timeframe which shall not exceed ten (10) days (unless otherwise noted herein) **[Cal-Am note: Those items to be given more than 10 days will be determined by the parties at a later time.]** 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; **[Cal-Am note: Cal Am will agree to this item only after is has sought and received concurrence regarding this matter from the State Water Resources Control Board, the CPUC, and the parties to the currently-tolled litigation pending before the Santa Clara County Superior Court relating to SWRCB Order 95-10 and the associated**

**Deleted:** **Basis for Public Participation in Project Governance**¶
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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.¶
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**Cease and Desist Order.]**

2) Select the Certified Value Engineer (to facilitate and report on the value engineering for the Project);

3) Subsequent to the selection of the design-build contractor for the Project, issue decisions concerning Project aesthetics consistent with community values if the decision would, in the opinion of the design-build contractor, have no financial impact on the cost of the Project; and

4) Issue decisions concerning procurement of alternative (non-PG&E) energy supplies for the Project, including waste-to-energy, so long as such decisions result in lowering the estimated unit price for power. **[Cal-Am note: Even if an alternate energy supply is procured, Cal Am intends to install a PG&E connection for redundancy purposes.]**

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 meet quarterly with Cal-Am to review Project-related expenses. Further, Cal-Am will, upon request from the Governance Committee, provide copies of all financial-related documents pertaining to the Project that have been submitted by Cal-Am to the CPUC.

**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) Review and evaluate proposals from qualified contractors for the pipeline, Aquifer Storage and Recovery and terminal reservoir construction bids, and source water wells, as applicable; **[Cal-Am note: The parties must review and consider confidentiality issues relating to bid opening and review of qualifications.]**

2) Participate in the selection of the design and engineering professionals for the design-build contract for the Project;

3) Review and issue determinations concerning material changes to the Basis of Design for the Project;

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

5) During the development of the procurement documents, determine Project aesthetics consistent with community values;

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

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

8) Review and determine whether to approve any contract change order in excess of $1 million.

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

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<#>Approve any major change order over $1 million;¶
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1) Cal-Am shall monitor the design, engineering, and permitting of all elements of the Project and report on same to the Governance Committee on a quarterly basis. Discussion of progress, challenges and areas of key importance shall occur;

2) Review contract terms to be included in all major construction contracts for the Project valued in excess of $1 million;

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;

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

7) Provide the Governance Committee with quarterly progress reports during major design milestones (i.e., 30% Design, 60% Design, 90% Design, and Final Design) and information on any material changes to the Project design.

**NEXT STEPS**

The proposals set forth above provide a general outline of a potentially acceptable governance framework 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.

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.

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**Deleted:** 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.¶

**Deleted:** **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.¶ ... [2]

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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.
Charles McKee, Monterey County Counsel
David Stoldt, Monterey Peninsula Water Management District, General Manager
Lew Bauman, County of Monterey, County Administrator

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### 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.

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## 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:

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;

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;

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.

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

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.

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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.