BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

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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	A.04-09-019

OPENING BRIEF
OF MONTEREY COUNTY WATER RESOURCES AGENCY

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SUMMARY OF REQUESTED RELIEF

(Rule 13.11 of the Commission's Rules of Practice and Procedure)

The Monterey County Water Resources Agency respectfully requests that the Commission grant the following relief:

1. Based on the overwhelming evidence in support of the settlement, find the settlement to be reasonable in light of the whole record, consistent with law, and in the public interest.

2. Adopt the Settlement Agreement (ex. 363) and approve the Water Purchase Agreement (ex. 301) as presented at the hearing without any modification.

3. Authorize California-American Water Company to enter into the Settlement Agreement and Water Purchase Agreement.

4. Grant California-American Water Company a Certificate of Public Convenience and Necessity to construct the CAW Facilities.

5. Reject ***all*** modifications proposed by Division of Ratepayer Advocate and the Monterey Peninsula Water Management District as neither reasonable nor in the public interest. Modifications to be rejected include but are not limited to:

   a. DRA's proposed product water cost cap.

   b. DRA's proposal that the Commission require slant wells if testing proves such wells to be feasible.

   c. DRA's proposal to require a year-long pilot test.

   d. DRA's proposal in written testimony to eliminate the partial second pass for boron and its proposal, newly minted at hearing, to await results of a pilot test before deciding whether to include a partial second pass for boron.

   e. DRA's proposal that MCWD customers pay more than their avoided cost for desalinated water.

   f. DRA's proposal to impose a source water contingency plan that differs from that called for in the WPA.

   g. DRA's proposal to revise the WPA's provisions concerning competitive procurement.

   h. WMD's request to be made a party to the WPA.

   i. WMD's request to be included in the governance of the Regional

Desalination Project, including but not limited to its request to be a member of the Advisory Committee established in the WPA.

j. WMD's proposals concerning inclusion of the Brown Act, the Public Records Act, and the Fair Political Practices Act.

k. The proposal of DRA and WMD that the Commission require the parties to file a declaratory relief action.

6. Require periodic status reports from California-American Water as set forth in Section IV.I below.

7. As time is of the essence, should any party request final oral argument, schedule that argument to occur immediately after issuance of a proposed decision.

I. INTRODUCTION.

For fifteen years Monterey Peninsula water consumers have lived under the shadow of an order of the State Water Resources Control Board ("SWRCB") that requires California-American Water Company ("CAW") to drastically reduce its take of water from the Carmel River system, including surface water and water pumped from Carmel Valley wells. Various abortive attempts to arrive at a solution have occurred during that time period, but until the negotiation of the Settlement Agreement ("SA") and Water Purchase Agreement ("WPA") at issue in this proceeding, no viable solution materialized. Now, after months of negotiation and meticulous drafting, a coalition of parties[1] to this proceeding has proposed a solution, the Regional Desalination Project ("RDP"). The RDP is an historic public-private partnership that will develop a desalination project to provide CAW with a replacement water supply while surmounting challenging legal hurdles forbidding both public ownership of a desalination plant in Monterey County and export of groundwater from the Salinas River Groundwater Basin ("Salinas Basin").

The Monterey County Water Resources Agency ("MCWRA") is one of the settling parties and an indispensable party to the WPA under which the RDP will be developed and water will be provided to Monterey Peninsula residents. MCWRA gets no benefit from the RDP and is involved to advance the public interest in development of a water solution for Monterey County. Without MCWRA's involvement, compliance with the provisions of the Monterey County Water Resources Agency Act ("Agency Act") prohibiting export of groundwater from the Salinas Basin would not be ensured.

On October 20, 2009, the SWRCB issued a final Cease and Desist Order (Order No. WR 2009-0060) ("CDO"), giving CAW until the end of 2016 to massively reduce its take of water from the Carmel River system. The RDP is the only project available that will allow CAW to obtain a replacement water supply in time to comply with the CDO. A denial of the motion for approval of the settlement will wreak havoc on the Monterey Peninsula, generating an economic and public health and safety disaster. Further, Commission modification of the settlement would create a significant risk that one or more of the Settling Parties would refuse to accept the

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[1] The Settling Parties are California-American Water Company, Marina Coast Water District, Monterey County Water Resources Agency, Monterey Regional Water Pollution Control Agency, Public Trust Alliance, Surfrider Foundation, and Citizens for Public Water.

modifications, leading to the end of the RDP after many months of very hard work necessary to reach agreement on the WPA and SA. Such a result must be avoided.

MCWRA urges the Commission to approve CAW's entry into the Settlement Agreement and Water Purchase Agreement without further modification, and to grant CAW a certificate of public convenience and necessity authorizing construction and operation of the facilities CAW will own under the WPA.[2]

II. MCWRA AND A BRIEF HISTORY OF EFFORTS TO CREATE A NEW WATER SUPPLY FOR THE MONTEREY PENINSULA.

A. Background Concerning MCWRA.

MCWRA is a public agency created by a special act of the California Legislature, the Monterey County Water Resources Agency Act, found in Chapter 52 in the Appendix to California Water Code. MCWRA is the successor to the Monterey County Flood Control and Water Conservation District, which existed under the Monterey County Flood Control and Water Conservation District Act (Chapter 699 of the Statutes of 1947) until its repeal in 1990. Under Section 52-4 of the Agency Act, the Agency consists of all the territory of Monterey County that lies within Monterey County's exterior boundaries. Ex. 500 (MCWRA/Weeks Rbtl) 3:25-31.

MCWRA is governed by a Board of Supervisors. The Monterey County Board of Supervisors is ex officio the Board of Supervisors of MCWRA. Ex. 500 (MCWRA/Weeks Rbtl) 4:6-7. The MCWRA Board of Supervisors is ultimately responsible to adopt all ordinances, resolutions, and other legislative acts of MCWRA. Ex. 500 (MCWRA/Weeks Rbtl) 4:20-21. The MCWRA Board of Supervisors appoints a nine-member Board of Directors, one each appointed by each Supervisor, and four others from nominees of four local Monterey County constituencies. One director for each of those nominating bodies is selected. Ex. 500 (MCWRA/Weeks Rbtl) 4:7-13.

The MCWRA Board of Directors is generally responsible to initiate and develop proposals for MCWRA. Subject to review by the Board of Supervisors, the Directors establish long-term and short-term policy objectives for the Agency, oversee implementation of those objectives, prepare an annual budget for MCWRA, hold public hearings on the proposed budget,

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[2] MCWRA reserves the right to address issues raised by other parties in its Reply Brief to be filed on July 16, 2010.

and, after approval of the budget by the Directors, submit the budget to the Supervisors for adoption. Ex. 500 (MCWRA/Weeks Rbtl) 4:14-19.

B. <u>The Agency Act and the Settlement.</u>

Ensuring compliance with the Agency Act, MCWRA's governing statute, is the central concern of MCWRA with any regional water solution, and that concern is reflected in the WPA. The most critical provision appears in Section 52-21 of the Agency Act, mandating that no groundwater from the Salinas Basin "may be exported for any use outside the basin, except that use of water from the basin on any part of Fort Ord shall not be deemed such an export. If any export of water from the basin is attempted, the Agency may obtain from the superior court, and the court shall grant, injunctive relief prohibiting that exportation of groundwater." Also important are related provisions in Sections §§ 52-9(d)(6) & (7) and 52-9(u) granting MCWRA the power to "[p]revent interference with, or diminution of, or declare rights in, the natural flow of any stream or surface or subterranean supply of waters used or useful for any purpose of the Agency or of common benefit to the lands within the Agency or to its inhabitants. . . ", to "[p]revent unlawful exportation of water from the Agency . . .", and to "[p]revent the export of groundwater from the Salinas River Groundwater Basin, . . .". Ex. 500 (MCWRA/Weeks Rbtl) 4:28 - 5:9.

MCWRA has taken various actions to protect those water resources the Agency Act mandates it protect, including the Salinas Basin and the Salinas River, against waste, improper extraction, and improper export. Over the years MCWRA and its predecessor have developed or maintained projects such as the San Antonio and Nacimiento Dams, the Castroville Seawater Intrusion Project ("CSIP"), the Salinas Valley Reclamation Project, and the Salinas Valley Water Project. Each of these projects has assisted and continues to assist MCWRA in bringing the Salinas Basin back into balance and slowing or stopping seawater intrusion. Ex. 500 (MCWRA/Weeks Rbtl) 5:26-33.

These actions over the years were vital to the ability of MCWRA to be involved in and support the settlement. The protection and progress toward rebalancing of the Salinas Basin made possible by those projects has led the agricultural community in the Salinas Valley, which relies on Salinas Basin groundwater, to be open to a project such as the RDP. In the past concern that water would be improperly exported from the Salinas Basin could have led to litigation and perhaps even an effort to adjudicate the Salinas Basin, which would have taken years and cost

vast sums of money. Confidence in MCWRA and its commitment and ability to prevent that from occurring has led to willingness from agricultural interests to support a regional solution. Ex. 500 (MCWRA/Weeks Rbtl) 7:10-18.

C. MCWRA Has Consistently Supported a Regional Water Supply Solution.

MCWRA has no need to participate in the RDP, but does so to advance the public interest. As early as 2004, MCWRA, as the only countywide organization with the breadth of responsibility for regional water supply planning that the Agency Act places on MCWRA, maintained that the CAW Coastal Water Project be designed to accommodate regional needs. Ex. 500 (MCWRA/Weeks Rbtl) 6:4-8. As possible desalination projects developed over the years and it appeared CAW's Moss Landing proposal was not workable, it was MCWRA that first engaged in an effort to address regional water supply planning with Monterey Peninsula cities and water delivery and treatment organizations. This effort preceded the regional planning effort of the Division of Ratepayer Advocates ("DRA") known as REPOG. During the development of project alternatives in the DRA's REPOG process, the possibility of projects that might impact the Salinas Basin arose. Besides Agency Act concerns with any such project, MCWRA also had to be concerned about a desalination project that would be owned by CAW, since such a project must be publicly-owned under a Monterey County ordinance. Ex. 500 (MCWRA/Weeks Rbtl) 6:11-19.

MCWRA could at that point have simply refused to further participate in efforts to find a reasonable water supply solution. It could have relied on its obligations to protect the Salinas Basin to retreat from the project and let it be known that any project that threatened violation of the Agency Act would be met with litigation. But taking such a position would not have been in the interest of Monterey County or its residents, including the residents on the Monterey Peninsula served by CAW. Rather, acting under the Agency Act and with the public interest in mind, MCWRA determined to continue to be an active participant in the search for a regional water supply solution. This participation included seeking to determine whether a desalination project could be developed that would not violate the Agency Act. Ex. 500 (MCWRA/Weeks Rbtl) 6:20-28.

D. The Commission Does not Have Jurisdiction to Exercise Continuing Oversight or Regulatory Authority over MCWRA.

Both DRA and Monterey Peninsula Water Management District ("WMD") wish the Commission had jurisdiction to regulate MCWRA and another party to the WPA, Marina Coast

Water District ("MCWD"). In various places each suggests in some fashion the Commission should assert or maintain continuing oversight or jurisdiction over the public agencies. Comments of the Division of Ratepayer Advocates on the Proposed Settlement Agreement dated April 30, 2010 ("DRA Comments"), pp. 11 (3rd, 5th, 10th, and 11th bullets) & 39 - 40; ex. 600 (WMD/Stoldt) p. 11; ex. 602 (WMD/Fuerst) pp. 10, 12; Comments on Settlement by Monterey Peninsula Water Management District dated April 30, 2010 ("WMD Comments,") p. 8. However, as Administrative Law Judge Minkin noted on the last day of the hearing, the Commission has no such jurisdiction. Tr. 1769:24 - 1770:1 (ALJ Minkin). WMD's own expert also admitted from the stand that was the case, for both MCWRA and WMD. Tr. 1349:26 - 1351:3 (WMD/Stoldt).

This lack of jurisdiction is one of the major challenges to this or any public-private partnership coming before the Commission. However, as will be addressed in Section IV below, the Commission can proceed with this project with confidence that the costs incurred by MCWRA will be reasonable because they have to be, because processes in place ensure they will be, Because the WPA requires them to be, and because despite the lack of trust exhibited by DRA and WMD, there is no evidence in the record that MCWRA has expended public funds unreasonably in developing and operating other past capital projects.

III. THE RDP IS SUPPORTED BY THE MONTEREY COMMUNITY, WILL COST LESS THAN OTHER POSSIBILITIES, AND IS THE ONLY FEASIBLE PROJECT THAT WILL RESULT IN TIMELY COMPLIANCE WITH THE CDO.

A. The RDP Enjoys Broad Community Support.

Although as with any major project, especially one as groundbreaking as the RDP,[3] there are detractors, the RDP is overwhelmingly supported in the Monterey Community. The agricultural industry, the largest economic engine in the County, is a critical project supporter. This support stems from the emphasis the WPA parties placed on compliance with the Agency Act and the assurance MCWRA's involvement provides that no Salinas Basin groundwater will be exported out of the basin. The participation of the two public agencies, MCWRA and

[3] The details of the RDP are reflected in the SA and WPA, which are summarized in the Settling Parties' Motion to Approve Settlement Agreement filed on April 7. No purpose would be served with burdening the record by repeating that summary here. After workshops, the Settling Parties circulated revised portions of the WPA on May 19. These changes included revisions to Section 7.1(a) to clarify the intent to employ a financing plan and clarification of the application of the Fees Limit. See Appendix A to Notice of Agreed-Upon Revisions to Water Purchase Agreement dated May 19, 2010.

MCWD, have been instrumental in garnering support for the RDP. Ex. 501 (MCWRA/Collins Rbtl) 4:4-9; see 3:14 - 4-3.

The water extracted by MCWRA's intake wells comes from wells that are sited in the Salinas Basin. As such, the only entity that can operate and monitor them is MCWRA, either directly or by contract. Ex. 501 (MCWRA/Collins Rbtl) 3:16-19. MCWRA's ownership and control of the wells and extraction facilities for the brackish source water under the WPA facilitates MCWRA's exercise of its statutory authority over water from the Salinas Basin. Ex. 361 (MCWD/Lowrey Rbtl) 3:5-8. It has been the express purpose of the WPA parties to always comply with the Agency Act as this project has been devised and planned. The component of fresh water, albeit brackish, that is produced in this endeavor must stay in the Salinas Basin, in Zone 2C, one of MCWRA's assessment zones. Ex. 501 (MCWRA/Collins Rbtl) 3:19-22. MCWD is situated in and pays Zone 2C assessments. Despite having ample water supplies for now and the foreseeable future, MCWD has agreed to use desalinated water as the balancing piece to ensure compliance with the Agency Act because that use by MCWD will result in water not being exported from the Salinas Basin. Ex. 501 (MCWRA/Collins Rbtl) 3:21-22 & 27-30.

Besides this crucial support from the agricultural community, every mayor and City Council in the service area has endorsed this project and the list of public agency support is significant. Ex. 501 (MCWRA/Collins Rbtl) 4:15-16. The list of supporters other than the Settling Parties includes every city in the Monterey region, the Seaside Water Master Board, and numerous public and political organizations, including Monterey County Hospitality Association, Monterey County Business Council, Monterey County Association of Realtors, Monterey Commercial Property Owners Association, American Institute of Architects Monterey Bay Chapter, Monterey Peninsula Chamber of Commerce, Pacific Grove Chamber of Commerce, Carmel Chamber of Commerce, Carmel Valley Chamber of Commerce, Seaside/Sand City Chamber of Commerce, Carmel River Steelhead Association, Carmel River Watershed Conservancy, and the Del Monte Forest Property Owners Association. Ex. 305 (MCWD/Heitzman Rbtl) 8:9-20.

Such broad support is not surprising, since most citizens of CAW's Monterey Peninsula service area are painfully aware of the CDO and the horrible impact it could have on their lives. They recognize the value of an engineering solution that provides water for now and the long term versus lawsuits and regulatory compliance which erodes property values, reduces water

availability to unsafe levels and potentially increases costs as much as the RDP would, without the provision of any new water. Ex. 501 (MCWRA/Collins Rbtl) 4:16-22.

This support from local communities and elected officials will have a positive impact on the development of the RDP, streamlining specific local permitting as compared to the other alternative desalination projects. Ex. 100 (CAW/MacLean Rbtl) 7:11-14.

B. <u>The CDO Makes Timing of the RDP Critical.</u>

The CDO is a real threat. A stay that was in place was lifted in April 2010. Ex. 100 (CAW/MacLean) 6:9-10; ex. 501 (MCWRA/Collins Rbtl) 7:7-8. Based on his knowledge and experience, MCWRA witness Mr. Collins stated in testimony that was neither challenged nor cross-examined that the SWRCB, with whom MCWRA has an excellent working relationship, has made it very clear that implementation of the CDO is being held only until a clear path from Monterey County is presented showing what is being done to solve these issues locally. It is Mr. Collins' opinion that if the RDP fails, implementation of the CDO will be inevitable. Ex. 501 (MCWRA/Collins Rbtl) 7:3-7.

The CDO requires CAW to reduce its use of water from the Carmel River drastically by the end of 2016, reducing its diversions from the Carmel River in increasing amounts from 10,209 AFY in 2009-2010 to 3,376 AFY in 2016-2017. Ex. 100 (CAW/MacLean Rbtl) 6:10-12. This amount of water will not serve even the most basic needs of CAW Monterey customers. Ex. 103 (CAW/Stephenson Rbtl) 9:17 - 10:2. As a result, CAW simply must have an alternative water supply in place no later than 2016. Ex. 103 (CAW/Stephenson Rbtl) 10:6-8. Along with the permitting, design and construction time required for any major capital project, the Settling Parties will need time to address any additional impediments that may occur before the Regional Desalination Project can come on-line. Ex. 100 (CAW/MacLean Rbtl) 4:18-21. The Regional Desalination Project is the only presently available alternative that can be permitted and built in time for CAW to meet its obligations under the CDO. Ex. 100 (CAW/MacLean Rbtl) 7:9-11.

C. <u>The RDP is the Only Feasible Project.</u>

The Final Environmental Impact Report ("FEIR") considered three alternatives, the Moss Landing Project, the North Marina Alternative, and the Regional Desalination Project. Ex. 100 (CAW/MacLean) 7:6-7. CAW determined that the RDP was the only alternative analyzed by the FEIR that could successfully be developed in time to meet the CDO. Ex. 100 (CAW/MacLean) 7:7-11.

1. Moss Landing and North Marina are not Feasible.

The Moss Landing project's open intake and once-through cooling design is environmentally controversial and subject to increasingly restrictive regulations. Ex. 100 (CAW/MacLean) 7:24-25; ex. 319 (MCWD/Melton Rbtl) 25:7-17. It also faces issues due to the Monterey County ordinance that requires any desalination plant in Monterey County to be publicly owned.[4] Ex. 501 (MCWRA/Collins Rbtl) 5:26-28; ex. 305 (MCWD/Heitzman Rbtl) 3:19-21. Building a delivery system from Moss Landing would involve significant challenges due to the environmental mitigations necessary to lay pipeline in a sanctuary and wetlands. Ex. 501 (MCWRA/Collins Rbtl) 6:1-3.

Nor is North Marina a feasible project. The North Marina Alternative, which CAW would own if it were developed, would require CAW to engage in controversial property acquisitions along the coastline, which could result in public animosity against the project and perhaps litigation. North Marina also faces issues due to the same Monterey County ordinance discussed above. Ex. 100 (CAW/MacLean) 7:26 - 8:4; ex. 501 (MCWRA/Collins Rbtl) 5:26-28; ex. 305 (MCWD/Heitzman Rbtl) 4:13 - 16. Further, unlike the RDP, the North Marina alternative would not have the voluntary and critical support of MCWRA or MCWD, which would be a huge problem in light of the Agency Act. Ex. 501 (MCWRA/Collins Rbtl) 6:8-11; see ex. 319 (MCWD/Melton Rbtl) 25:19-23. North Marina also involves use (as opposed to study) of unproven slant well technology. Ex. 305 (MCWD/Heitzman Rbtl) 4:12-14.

In fact, there has not really been any evidentiary challenge to the lack of feasibility of the Moss Landing or North Marina possibilities. DRA asserts in its comments on the settlement the Commission may modify the settlement and if the Settling Parties do not accept such modifications, "the Commission may select one of the alternatives described in the Commission's Final EIR on the Coastal Water Project." DRA Comments, p. 4. However, DRA submitted no evidence supporting the feasibility of) either project it asserted the Commission could select, or showing any other project could be completed in time for CAW CDO compliance.

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[4] Monterey County Code of Ordinances § 10.72.030.

2. The No-Project Alternative Would be Disastrous.

The Final EIR also considered a "No Project Alternative," that is, doing nothing to address CAW's need to comply with the CDO. Ref. Ex. B (FEIR) § 7.6.2.1, p. 7-49 ff. The No-Project Alternative could arise in two ways. The Commission could refuse to approve the settlement, or approve the settlement but with modifications unacceptable to the Settling Parties. See ex. 363 (MCWD) §§ 6.2 & 6.3,[5] pp. 8-9. In either event, the result would be the same: CAW would reach the end of 2016 without a new water supply and face enforcement of the CDO.

The evidence overwhelmingly proves the No-Project Alternative would be an economic and public health disaster. Based on his experience as a lifelong resident in Monterey County, a Monterey County business person, a member of the MCWRA Board of Directors, and liaison to the Board of Supervisors from the MCWRA Board of Directors, Mr. Collins stated his opinion that public health and safety would be threatened by the dramatic drop in the amount of water CAW would have available to deliver to its customers. He also noted possible social justice issues that would arise if wealthier Peninsula residents that could afford to do so were to install water storage at their residences and truck water in to be sure they had water while others did not. Further, he termed the economic consequences "frightening," involving shuttering half of the hotel rooms and restaurants closing, which would have negative economic consequences for the Monterey Peninsula's vital tourism trade. Ex. 501 (MCWRA/Collins Rbtl) 7:9-27.

While Mr. Collins' opinion as an experienced business person and local political leader is entitled to significant weight, his opinions are strongly supported by the expert economic testimony of Dr. Mark Berkman. Dr. Berkman notes substantial hardships for residential customers including reduced bathing, clothes washing, and waste removal and elimination of recreational and aesthetic benefits of water use, with a conservative quantification of between $17 and $51 million annually. Further, Dr. Berkman concludes industrial and commercial customers will be forced to reduce output and employment to cope with reduced water supplies, leading to estimated annual industrial sales losses (primarily food processing) within the CAW service territory of $261 million, annual commercial sales losses (including grocery stores, restaurants, hotels, laundries, and hospitals) of $742 million, and employment losses of nearly

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[5] Even if other Settling Parties wish to accept a Commission modification, failure of one or more than one of CAW, MCWRA, or MCWD to accept a Commission modification will render the Settlement Agreement null and void. Ex. 363 (MCWD) § 6.2, p. 8.

6,000 jobs. Ex. 326 (MCWD/Berkman Rbtl) 3:5-17; 12:17-25. As to employment, payroll losses range from more than $7 million in the industrial sector to $223 million in the commercial sector, which represents approximately 179 industrial jobs (22% of such jobs in the CAW service territory) and more than 5,600 commercial sector jobs (10% of such jobs in the CAW service territory). Ex. 326 (MCWD/Berkman Rbtl) 12:15-25; 18:1-3.

Simply put, given these impacts, the No-Project Alternative is no alternative at all. That, combined with the infeasibility of Moss Landing and North Marina, leaves the RDP as the only alternative.

3. The RDP Is the Least Expensive Possibility.

Evidence from Mr. Melton establishes that the RDP is less expensive than either the Moss Landing or the North Marina project alternatives. Taking North Marina first, based on the capital cost and annual operating cost, Mr. Melton notes it might be expected that the unit costs of water for the RDP as set forth in Exhibit C[6] to the WPA would be similar to those of North Marina. However, the cost of water is also highly dependent on the financing terms of the project. Because the cost of financing for project reflected in Exhibit C is lower than that of North Marina, the net cost of water for the RDP under the cost estimates in Exhibit C is substantially lower than the North Marina project, as shown in the Project Financing section of Mr. Melton's rebuttal testimony. Ex. 319 (MCWD/Melton Rbtl) 13:26 - 14:4. Further, as Mr. Collins observed, since CAW would own the North Marina project, CAW's investment in plant, wells, and pipelines would garner a return on investment. Ex. 501 (MCWD/Collins Rbtl) 6:14-16.

As to Moss Landing, Table 3 on page 13 of Mr. Melton's rebuttal testimony (Ex. 319) shows that the Most Probable Capital Cost with Contingency (for the public agency facilities of the RDP) is $70 million less than the Most Probable Capital Cost with Contingency for Moss Landing, and that the cost reflected on Exhibit C for the same facilities for the RDP is $26 million less than the Most Probable Capital Cost with Contingency for Moss Landing. This does not take account of reductions in costs that could come into play with grants and low interest loans. Ex. 319 (MCWD/Melton Rbtl) 12:18-21. Mr. Collins' observations about return on investment for North Marina would also apply to Moss Landing.

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[6] Exhibit C to the WPA was created to establish an upper cost limit that was included in the WPA. Exh. 319 (MCWD/Melton Rbtl) 6:13-14.

Further, Table 6 on page 24 of Mr. Melton's rebuttal testimony (Ex. 319) shows that "even the most conservative estimate of the first year costs of water for the Regional Desalination Project is lower than any of the North Marina or Moss Landing estimates. Regardless of the financing scenario used, the Regional Desalination Project is the lowest cost alternative." Ex. 319 (MCWD/Melton Rbtl) 24:27 - 25:2.

D. Modifications to the Settlement Very Well Could Result in the "No-Project Alternative."

After the public workshops held with respect to the settlement on May 10-12, 2010 at the Commission, the Settling Parties circulated certain clarifying revisions to the WPA which they accepted. Ex. 305 (MCWD/Heitzman Rbtl) 22:8-15; see ex. 100 (CAW/MacLean Rbtl) 9:3-5. Those revisions are found in Exhibit 301.

These are the revisions the Settling Parties have found acceptable. Any other modifications could de facto lead to a No-Project Alternative because such modifications could be rejected under Article 6 of the SA (ex. 363). It will not be an easy process to obtain approval of any modifications to the settlement. They would have to be taken back to the governing boards of each Settling Party for approval. See Tr. 1072:12-20 (CAW/MacLean); ex. 305 (Heitzman Rbtl) 21:25 - 22:2; ex. 500 (MCWRA/Weeks Rbtl) 19:23 - 25; ex. 501 (MCWRA/Collins Rbtl) 6:28-30. Any modifications could upset the careful balance reached by the parties in the settlement. Ex. 501 (MCWRA/Collins Rbtl) 6:28-30.

MCWRA's General Manager Mr. Weeks identified some modifications he believes the MCWRA Board of Supervisors would find unacceptable. These would be any modifications that would lead to MCWRA recovering less than all the costs it has incurred in this proceeding and proceeding A.09-04-015, including the costs it has incurred in negotiating the settlement, and all capital and O&M costs expended in the future under the WPA, as well as any modifications that would threaten in any way a violation of the Agency Act or other Legal Requirements. Ex. 500 (MCWRA/Weeks Rbtl) 19:20 - 20:1. Mr. Heitzman also stated his opinion that any material modifications to the SA or WPA would be rejected by MCWD's Board. Ex. 305 (MCWD/Heitzman Rbtl) 21:25-22:3.

MCWRA urges the Commission to reject the requests of DRA and WMD to make changes to the settlement, changes each of those parties has to know have a strong likelihood of resulting in the No-Project Alternative. The Commission should instead approve the settlement with no revisions to the WPA other than those reflected in Exhibit 301.

E. The Commission Should Approve this Unique Public-Private Partnership.

MCWRA closes its discussion of the RDP as the only alternative that will lead to timely CAW compliance with the CDO with discussion about the RDP as a public-private partnership. Mr. Stoldt, a witness for settlement opponent WMD, noted the RDP "has unique features. . . What I see as the collective approach to satisfying a, really, a societal need in this region is really quite extraordinary. And I think there's many unique characteristics to the legal arrangement that satisfy a lot of needs of the parties that are very unique to this project." Tr. 1373:2, 8-13 (WMD/Stoldt). He agreed that a public-private partnership of this type is on balance a good thing. Tr. 1373:21-23 (WMD/Stoldt).

Although MCWRA and WMD are seriously at odds over the settlement, MCWRA appreciates Mr. Stoldt's candor about the public-private partnership aspect of the RDP. However, the Commission must set aside unjustified concerns from its own ratepayer advocate arm, DRA, to approve this public-private partnership. The evidentiary record, as well as DRA's comments on the settlement, demonstrate DRA simply has been unable to trust that the two public entities that are vital to CAW solving its water supply problems will behave properly, not try to "stick it to" CAW's ratepayers, follow their own strict procedures that govern their expenditure of public funds, and not, to quote Mr. Weeks' rebuttal testimony, "view Commission approval of the WPA as a license to spend money like the proverbial 'drunken sailor on leave.'" Ex. 500 (MCWRA/Weeks Rbtl) 11:16-17.

To approve this groundbreaking public-private partnership, the Commission must have the trust that DRA does not. The California Constitution, Public Utilities Code, and Water Code have set up different regulatory models for privately-owned public water utilities such as CAW and water agencies and districts such as MCWRA and MCWD. The Commission cannot and does not regulate MCWRA or MCWD, nor have any authority to examine their costs for reasonableness and prudence. Yet, as will be discussed in Section V.A.1 below, each agency must spend public funds reasonably, cannot make gifts of public funds, and has in place transparent budgeting procedures where public participation can and does occur. The Commission may and should conclude that these two public agencies, who are working diligently to help solve an old and difficult water supply problem in Monterey County, will indeed spend the public's money reasonably, which will lead to reasonable rates for CAW's ratepayers.

It is here that MCWRA departs from Mr. Stoldt, who believes that even if this public-private partnership is not approved, others will be offered. Tr. 1373:24 - 1374:4 (WMD/Stoldt). MCWRA is more pessimistic, because MCWRA is concerned that at the core of any nonapproval would be an unwillingness to accept that MCWRA and MCWD will only spend reasonable sums in developing and operating the RDP. If the Commission cannot trust that MCWRA and MCWD will act in that manner, MCWRA doubts any public-private partnership where the private partner is a Commission-regulated utility will ever be approved. On the other hand, MCWRA believes just as strongly that approval of the settlement will be a strong step into an era of cooperation between public and private entities that the State sorely needs, especially in the area of water supply.

IV. COST ISSUES.

A. MCWD and MCWRA Costs Must Be and Will Be Reasonable.

1. MCWRA and MCWD Follow Processes that Encourage Public Participation and Lead to Reasonable Expenditure of Public Funds.

DRA attacks the reasonableness of the expenditures by the public agencies with respect to the development, construction, and future operations of the RDP, even stooping so low as to imply, without any supporting evidence, that these two public agencies would engage in wasteful and imprudent spending.[7] DRA Comments, p. 66 & n. 134. In the DRA Comments, p. 67, DRA states: "There is no process by which the public can challenge the costs and have them excluded from the Product Water cost that Cal Am ratepayers will pay." (See also DRA Comments, pp. 10 and 57-58, asserting no settling party has an interest in assuring that rates CAW customers pay are reasonable.) Despite WMD's status as a public agency and understanding that the CPUC has no jurisdiction over it (see Tr. 1366:11-16 (WMD/Fuerst), WMD urges that public agency costs (including therefore MCWRA's) should not be presumed reasonable and prudent, and that the Commission should retain oversight over RDP costs to ensure CAW ratepayers pay fair and reasonable rates. Ex. 602 (WMD/Fuerst) pp. 10, 12.

However, the record shows that MCWRA and MCWD (and for that matter WMD) follow open and transparent budgeting processes, in which the public may and does participate, that

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[7] It is interesting that DRA is apparently willing to accept expenditures by its fellow settlement opponent WMD as reasonable. DRA recommends that the cost estimates for the RDP ASR wells be based upon "the actual historical cost expenditures incurred by MPWMD to design and construct the Phase 1 ASR Wells." Ex. 202 (DRA/Steingass) 2-16:19-22. Nowhere in DRA's testimony or otherwise in the record is there any indication that DRA reviewed these expenditures for reasonableness or prudence.

require expenditures to be reasonable and prudent. For each agency, therefore, the very process DRA claims does not exist is in place. For MCWRA, annual budget review and adoption includes a highly public two-part publicly reviewed budget process that proceeds through a series of publicly-noticed all day workshops that any member of the public may attend, after which the MCWRA Board of Directors votes on the budget. After that, the same process occurs again before the MCWRA Board of Supervisors, again with opportunity for public participation and input. Ex. 500 (MCWRA/Weeks Rbtl) 10:18 - 11:11. Monterey Peninsula residents may participate in this process. In fact, the Peninsula is represented by two specific Board of Directors members as well as by two specific Board of Supervisors members who as already noted directly appoint two members of the Board of Directors. Peninsula residents have the ultimate power of the ballot to remove Board of Supervisors members if those residents are dissatisfied with their performance. Ex. 500 (MCWRA/Weeks Rbtl) 11:1-6. Finally, after the annual budget is adopted, MCWRA expenditures are reported on a monthly basis and the public may attend a Board of Directors meeting and comment during the public comment period on those expenditures. Ex. 500 (MCWRA/Weeks Rbtl) 11:7-11.

MCWRA will not summarize the process followed by MCWD, other than to note it is open, transparent, and closely monitored by the public. Mr. Heitzman discusses it in his Rebuttal Testimony (ex. 305) at 17:4-15. Mr. Lowrey, general counsel for MCWD, testified that legal provisions public agencies have to follow, including Brown Act, the Public Records Act, Article XIII D of the California Constitution, and the Mitigation Fee Act (Gov. Code §§ 66000 et seq.) provide assurances of the prudency and reasonableness of public agency costs. Ex. 361 (MCWD/Lowrey Rbtl) 1:17-20; 5:10-16.

Settlement opponent WMD follows a similar process, as was developed on cross-examination. Mr. Fuerst, WMD's General Manager, agreed that the practical result of WMD's public and transparent budget process and going through different committees and the board was that WMD is legally required to be reasonable and prudent in the expenditure of public funds. Tr. 1366:21 - 1368:3 (WMD/Fuerst). He noted that the process MWD follows is "[s]imilar to the other agencies, . . .". Tr. 1366:21 (WMD/Fuerst). He agreed that WMD constituents could seek judicial relief if they believed WMD was expending costs in an imprudent or unreasonable fashion. Tr. 1367:7-18 (WMD/Fuerst).

The evidence before the Commission establishes that MCWRA expended funds reasonably in the past with respect to a regional project to desalinate water and negotiation of the agreements that will lead to development of the RDP, and will do so in the future when they expend funds in the future for design, construction, and operation of the RDP.

2. Evidence Demonstrates MCWRA Expends Funds Reasonably on Capital Costs, and the Record Contains No Evidence of Unreasonable Expenditure of Funds by MCWRA.

Given DRA's and WMD's concerns with reasonable expenditure of funds that will make their way into CAW rates, it might be expected that DRA would look into whether MCWRA had ever unreasonably expended funds on any other capital projects. However, it did not. This is discussed in Mr. Weeks' rebuttal testimony (Ex. 500). Mr. Weeks explains that, expecting DRA's attack on the reasonableness of MCWRA expenditures, MCWRA sent DRA a number of data requests inquiring whether DRA contended that MCWRA had expended funds unreasonably in developing, designing, constructing, and/or operating the following MCWRA projects: Nacimiento Reservoir, San Antonio Reservoir, CSIP, the Salinas Valley Reclamation Project, and the Salinas Valley Water Project. Another data request asked whether DRA contended whether MCWRA had expended funds unreasonably in developing, designing, constructing, and/or operating any capital project. MCWRA also asked in a data request whether DRA contended that MCWRA has expended funds unreasonably with respect to the Regional Desalination Project. DRA's response to each such request was the same: "DRA responds that it does not have sufficient knowledge to contend or not contend that MCWRA has expended funds unreasonably . . .". Thus, DRA possesses and certainly presented no evidence that MCWRA has expended funds unreasonable on past capital projects or the RDP. Ex. 500 (MCWRA/Weeks Rbtl) 9:22 - 10:11. DRA had every opportunity to look into this issue, but apparently chose not to do so.

Further, there is evidence in the record that MCWRA has expended public funds on capital projects reasonably. Mr. Collins has been a member of the MCWRA Board of Directors since 1996. Ex. 501 (MCWRA/Collins Rbtl) 1:23-24. During his time on the Board of Directors, MCWRA has planned, financed and built the Castroville Seawater Intrusion Project, the Salinas Valley Reclamation Project, the Salinas Valley Water Project and the renovation Project at Nacimiento Reservoir, which have a combined financing cost in excess of $110 million. Mr. Collins explains that in each case, MCWRA brought the project in on time, once

construction began, and in three of the four on or under budget. The fourth project was 20% below the engineer's budget but environmental mitigations brought the project in slightly over the construction budget, but within contingency. Ex. 501 (MCWRA/Collins Rbtl) 1:27 - 2:2; see also ex. 319 (MCWD/Melton Rbtl) 9:7-11 (concerning MCWRA's development of capital improvements over the last 15 years).

B. <u>The Settling Parties' Cost Projections are Appropriate.</u>

1. The Record Supports Reliance on the Cost Projections Provided by RMC.

RMC Water and Environment ("RMC") originally prepared detailed capital and O&M cost estimates for a Phase 1 regional project, which were presented in a Cost Comparison Exhibit of August 14, 2009, and presented in testimony dated on August 20, 2009. Ex. 306 (MCWD/Melton) 23:22-27:2. Revisions to that cost estimate, based on updated information and further refinement of the RDP, are reflected in Mr. Melton's Rebuttal Testimony. Ex. 319 (MCWD/Melton Rbtl) 3:19-22; & see generally 3:23 - 8:19. RMC's qualifications and those of Mr. Melton to prepare such detailed cost estimates are impeccable (see Ex. 306 (MCWD/Melton) 1:19 - 3:12), and have undergone no attack.

Attached to the WPA is Exhibit C, which was created to establish an upper cost limit that was included in the WPA. It differs from the Proposed Regional Desalination Project costs shown in the April 15, 2010 Project Cost Comparison. The basis for the Exhibit C costs is included in the April 15, 2010 Project Cost Comparison. The costs included in Exhibit C assume that the intake facilities will include all slant wells (to be conservative), that there will be a different connection point for introduction of the desalinated water in the MCWD distribution system that requires a 12,750 foot long, 24-inch diameter MCWD tie-in pipeline, that there will be no MCWD buy-in fees, and that the costs will be at the high end of the cost estimating accuracy range as established by the Association for the Advancement of Cost Engineering . The resulting cost estimate included in Exhibit C is $240 million for the most probable cost, and $282 million at the high end of the accuracy range. These costs include all costs of the RDP except the costs of the CAW Facilities (i.e., they include the costs to deliver desalinated water to the Delivery Point, or, otherwise stated, all project costs upstream of the Delivery Point). The Exhibit C costs in the WPA also include $15 million for the Reserve Fund Payment Account and the costs of obtaining indebtedness, bringing the total Exhibit C costs in the WPA to $297 million. However, the latter two cost items will be replaced by financing costs from the Unified

Financing Model. Ex. 319 (MCWD/Melton Rbtl) 6:13 - 7:5. It is important to realize that Exhibit C costs are higher than the WPA Parties actually expect the Most Probable Cost with Contingency for the public agency facilities to be. See Ex. 319 (MCWD/Melton Rbtl) Table 3, p. 13. Exhibit C is therefore a conservative cost estimate.

Further, it is appropriate at this time to concentrate on estimated capital costs. The costs at this time are estimates, as everyone agrees, including DRA. Ex. 203 (DRA) Att D, 1st pg., 6th ¶. The parties will create and follow a financing plan; they have committed to use reasonable efforts to get the lowest cost financing; and public agency participation permits access to lower cost debt as wells as grants and SRF loans. Ex. 301 (MCWD) § 7.1(a), p. 39; as to grants and loans, see ex. 305 (MCWD/Heitzman) 14:1-6. Further, although various scenarios have been run for differing interest rates, at the end the day, as Mr. Stoldt testified on cross-examination, "the cost of debt is whatever the cost of debt is." Tr. (WMD/Stoldt) 1295:17-18. That cost of debt will apply, whatever the capital cost, further supporting concentrating on estimates of capital cost at this time.

Regardless of which RDP cost estimate is considered, the estimate is based on a desalination plant with a capacity of 10,500 acre feet. That is the proper size for the plant. The plant is sized to be able to provide CAW with replacement water supply while also being certain Salinas Basin groundwater is not exported from the Salinas Basin. Tr. 1172:15 - 1173:27 (MCWRA/Weeks). In addition, MCWD has agreed to adjust its groundwater pumping operations to rely on groundwater during the summer so that CAW can receive the full 10 mgd flow rate from the desalination plant during CAW's peak demand period. MCWD will then make up the water it must take to be certain Salinas Basin groundwater is not exported during the winter months when CAW demands are lower. This provides a large benefit to CAW ratepayers and allows for a smaller sized desalination plant capable of meeting CAW's peak demand. Ex. 319 (MCWD/Melton Rbtl) 10:2-12; Tr. 1174:10-28 (MCWD/Heitzman).

2. The Partial Second Pass for Boron Is Necessary.

For inexplicable reasons, DRA has made the partial second pass for removal of boron a central issue in this case. Bluntness is appropriate here: DRA is willing to put public health and safety and CAW's relationship with its customers as to the water it sells them at risk over a 3% overall increase in the capital cost of the project. See Ex. 319 (MCWD/Melton Rbtl) 30:23-25; Tr. 1725:3-13 (MCWD/Trussell). The old adage "Penny wise and pound foolish" applies.

First, both Dr. Trussell and Mr. Melton testified as to why it is important, for public health and safety and operational reasons, to include in plant design a partial second pass for boron. Ex. 386 (MCWD/Trussell Rbtl) 2:6-23; 3:9 -5:26; ex. 319 (MCWD/Melton Rbtl) 30:10-27. Mr. MacLean explained that if CAW were required to issue notices to its customers alerting them of high concentrations of boron, customers may perceive such notices as a risk to public health and safety and have questions about the quality of the water CAW delivers. Ex. 100 (CAW/MacLean Rbtl) 9:22 -10:8.

Second, DRA has changed its story on this issue. Dr. Shah's testimony stated, clear as a bell, its recommendation that the Commission adopt BoR's recommendation to "***Abandon*** the concept of a second pass for the RO systems as not necessary to meet existing CDPH notification level for Boron and secondary standards for sodium and chloride." Ex. 202 (DRA/Shah) 3-22:18-20 (bold italics added). Despite the clarity of this explanation, which was neither revised in a new version of DRA testimony nor corrected when Dr. Shah took the stand, Dr. Shah testified at hearing that what he really meant was that the project should go through a year-long pilot test before deciding whether the partial second pass was necessary. See, e.g., Tr. 1523:6-14 (DRA/Shah). The problem with this proposal is that a cost estimate needs to be approved now, not later. There is no time to wait on this issue and still make the CDO deadline, nor to determine that if the second pass is later decided to be necessary, the WPA Parties can come back to the Commission for a further allocation of money. The safe thing to do, especially over 3% of the costs of the RDP, is to budget for the second pass.

C. DRA's Cost Projections are Both Overly Conservative and Inconsistent.

Section VI of the DRA Comments on the settlement posit a high cost for water delivered from the RDP. Mr. Weeks testified that, although DRA does not show its math in these comments, it appears that where a high cost could be used, DRA used it, whether it is the estimate of construction costs, the interest rate, or when financing will occur. At the risk of a very bad pun, when it comes to the cost of water from the RDP, DRA has chosen the position that would have the glass half empty, not half full. By contrast, as discussed above, the settling parties have used more probable costs in their calculations. Ex. 500 (MCWRA/Weeks Rbtl) 12:8-10. Even the conservative projections in Exhibit C to the WPA (Ex. 301) are much lower than DRA's estimates. See discussion in Section IV.B.1 above.

Further, DRA's cost estimates and product water cost cap are inconsistent. When it is trying to argue that the RDP will be too expensive, DRA piles on the highest possible costs. However, when it wants to drive the cost of the RDP down without regard to the impact of doing so, it finds information that will allow it to suggest low cost caps on the MCWRA- and MCWD-owned facilities as well as the CAW facilities. The positions are not compatible. If DRA really believes its high costs, it cannot then claim a cost cap that is a fraction of DRA's high costs would be workable. Ex. 500 (MCWRA/Weeks Rbtl) 12:12-17.

D. <u>The WPA Contains Provisions Designed to Control and Contain Costs.</u>

DRA and WMD seems to assume that cost does not matter to the parties to the WPA, but the terms of the WPA prove such an assumption wrong. The parties to the WPA included cost containment provisions in that agreement. Section 4.3 of the WPA concerns Cost Management. It includes Value Engineering and requires the parties to endeavor to obtain at least three proposals for qualified contractors for each construction contract. Ex. 301 (MCWD) pp. 25-26. Section 4.6 requires a constructability review. Two of the objectives of the constructability review are to build a project that can be maintained in a cost-effective manner and to consider the lowest-achievable lifecycle cost in the operation and maintenance of the project. Ex. 301 (MCWD) p. 28. Section 6.5(h) requires the parties, in consultation with the Advisory Committee, to annually review and consent to the reasonableness and prudency of O&M Costs for the next Calendar Year. Ex. 301 (MCWD) p. 37. Section 11.2(d) requires that all costs of the Parties pursuant to the WPA be reasonably and prudently incurred. Ex. 301 (MCWD) p. 54; see ex. 500 (MCWRA/Weeks Rbtl) 11:13-26. Deviations from these requirements would be subject to correction by the procedures and remedies provided in the WPA for breaches of the WPA: Section 19, Dispute Resolution, and Section 20, Events of Default and Remedies. Ex. 305 (MCWD/Heitzman Rbtl) 12:27 - 13:3.

E. <u>The Capital Cost Cap Proposed in the Settlement Agreement and WPA Should be Adopted.</u>

The WPA defines "CPUC Settlement Cost Cap" as "the total limit for the Cost Estimate approved by the CPUC in the Settlement Agreement, including all related financing, insurance and attorneys' fees and expenses, but excluding interest during construction and any debt service coverage required to obtain the Indebtedness." Ex. 301 (MCWD) p. 9. "Cost Estimate" is defined in Section 4.3(a) of the WPA as "The estimated Initial Capital Costs of the Project Facilities as of March 14, 2010, excluding interest during construction and any debt service

coverage required to obtain the Indebtedness, [as] shown on **Exhibit C** hereto . . .". Ex. 301 (MCWD) p. 25 (bold in original). The Project Facilities are the parts of the RDP owned by MCWRA and MCWD. Ex. 301 (MCWD) Article 3, § 3.1–3.6, pp. 23-24. Thus, the CPUC Settlement Cost Cap applies to the Project Facilities to be owned by the two public agencies and is in the amount of $297,470,000 as stated on Exhibit C to the WPA.

Under Section 4.3(e) of the WPA, if the *actual or contracted* total of costs listed in Exhibit C will be higher that the *estimated* costs included in the CPUC Settlement Cost Cap, CAW must seek Commission approval of the excess costs. Ex. 301 (MCWD) § 4.3(e), p. 26. Thus, the parties to the WPA agree to a construction cost cap for the public agency facilities of approximately $297 million, ask the Commission to approve that cost estimate, and require CAW to request approval of amounts over that cap.

Testimony indicates that cost or price caps are not necessarily a good thing. Dr. Berkman testified price caps have not proved particularly effective at preventing cost increases, and notes continuing research and debate regarding their efficacy. Ex. 326 (MCWD/Berkman Rbtl) 6:14-22. Mr. Kalinovich explained that obtaining financing in the presence of a cost cap could be difficult. He noted that cost caps during construction might be managed through the construction contractor, but that a higher cap is more likely to be accepted by a lender than a lower one. If CAW can assure a banker that construction can occur under the amount of the cost cap, it may be possible to obtain financing to construct the project. See Tr. 1604:17 - 1605:1; 1606:3 - 1607:9; 1616:24 - 1617:28 (CAW/Kalinovich).

Discussion of the request of the parties to the WPA with respect to a cost cap occurred during the last day of hearing, which followed Mr. Kalinovich's testimony (on the third day of hearing) about the impact of a cost cap on the financing of the project. All three parties to the WPA expressed a preference that no cost cap be imposed in light of testimony such as Mr. Kalinovich's, noting that if a cost cap were imposed, it should be one based on the capital costs of the project rather than the dollar-per-acre-foot cap proposed by DRA. See generally Tr. 1758:14 - 1760:17 (various). Since the hearing, the parties to the WPA have discussed this issue. While they have concerns about the use of a cost cap, they also recognize they submitted the settlement to the Commission and suggested cost caps for both the publicly-owned facilities in the WPA, and for the CAW facilities in the SA. These cost caps are based on conservative estimates and Mr. Kalinovich's testimony underscores the importance of setting a conservative

cost cap if one is used at all. They therefore recommend that the Commission approve the cost caps they have proposed in the WPA and SA, but are not willing to accept any other cost cap.

Finally, as already noted, the costs in Exhibit C are conservative and thus the parties hope those costs will not be exceeded. However, MCWRA requests the Commission to state as part of its final decision that if CAW must return under WPA Section 4.3(a) for further cost authorization, the Commission will process any such request on an expedited basis. See comments by counsel for MCWRA at Tr. 1759:18-28.

F. The Product Water Cost Cap Suggested by DRA Should be Rejected.

DRA requests the Commission to impose an "all inclusive" cost cap of $2200 per acre foot. Ex. 202 (DRA/Shah) 1-4:13-21. This cost cap would lead to disallowance of any Product Water costs over the cap as unreasonable, unless CAW "or Parties jointly file a separate application for recovery of such costs with a full justification for exceeding the Cost Cap, including supporting documentation of full justifications for costs both above and below" the cap. Ex. 202 (DRA/Shah) 1-7:11 - 1-8:4.

The cross-examination of DRA's expert on this topic, Dr. Shah, conclusively demonstrated the lack of evidence to support this cost cap.

1. The Water Desalination Report Cost Data Has Been Thoroughly Discredited and Does not Support DRA's Cost Cap.

In a stunning admission, Dr. Shah stated he did nothing to independently verify the cost data in the table upon which he relied from an online industry newsletter, the Water Desalination Report. Tr. 1562:8-11(DRA/Shah); ex. 364; see also Tr. 1555:5-9 (Shah/DRA) (admitting he did no other research to determine whether the costs from ex. 364 were accurate) & 1556:13-18 (admitting that he did no analysis other than the analysis done by BoR with respect to the costs in Table 1 of his testimony).

These admissions alone compel rejection of the DRA product water cost cap. Their importance cannot be overstated. DRA wants the Commission to adopt a product water cost cap it knows the WPA parties oppose and thus threatens the construction of a plant that truly is the only chance CAW has of meeting the CDO deadline. Under such circumstances, it is appropriate to expect that DRA's proposal would exude gravitas. After all, DRA hired one of the foremost experts on water desalination in the country, Frank Leitz (through the BoR). Should not such an expert present a carefully researched and supported report on the price of product water that at least in some ways approximates the kind of product water that will be

provided by the RDP – that is, water for drinking produced by a plant being built to meet a state-imposed cease-and-desist order, which plant obtains water from intake wells located on the beach, and which plant cannot be built until it passes the significant regulatory hurdles presented by the State of California?

Unfortunately, it is clear that neither Mr. Leitz, the BoR, nor Dr. Shah conducted any such careful research. Instead, Dr. Shah basically took five numbers from an internet newsletter, did nothing to verify their accuracy, crunched some numbers, and proposed a product water cost cap. It is the lack of verification that is most critical and troubling. Thus, the fact that he did not know, one way or the other, the answers to many specific cross-examination questions from MCWD about specific plants upon which he relied is less important for their substance (Is the water at West Basin tertiary-treated recycled water used for industrial purposes? Are the costs at Tampa higher than he supposed and does Tampa desalinate less salty water?) [8] than for the fact that such lack of knowledge vividly demonstrates the impact of his admission that ***he did not even try to verify the accuracy of the costs upon which he was relying.***

Recognizing his pickle, Dr. Shah sought – on the fly, since his written testimony does not support the excuse he made under withering cross-examination[9] – to take refuge in the expertise of BoR, stating he relied extensively on its expertise since his data was a subset of the data the BoR used. Tr. 1492:6-10, 1555:1-3, 1555:10-12 (DRA/Shah). Unfortunately for Dr. Shah, he seeks shelter in a house of cards. Here is what Mr. Leitz has to say about the Water Desalination Report plant cost data:

> In the discussion that follows, numbers and costs relate to the Moss Landing Plant. Similar arguments can be made for the other projects; only the numbers will be a little different. When one looks at the total cost of water, the overall impression is that the water, which translates to $10.79/kgal, is expensive. [Footnote 16 omitted.] For comparison, a published list of sea water desalting plant product costs appeared in the Water Desalination Report[10]. ***For details, see referenced publication.***

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[8] MCWRA will not burden this brief with a litany of the information Dr. Shah did not know or consider about plants whose costs he used in generating his proposed cost cap. See generally Tr. 1484:22-1487:4; 1490:5-1491:7; 1494:9-1498:11; 1558:17-1560:15; 1561:20-24 (DRA/Shah). Mr. Melton explains the importance of such information in his rebuttal testimony, in order to allow an "apples-to-apples" comparison of costs. Exh. 319 (MCWD/Melton Rbtl) 27:21 - 28:9.

[9] Dr. Shah admitted he did not state in his written testimony that he relied upon BoR's expertise. Tr. 1555:10-15 (DRA/Shah).

[10] Water Desalination Report, September 15, 2008.

Ex. 204 (DRA/Leitz) p. 15 (bold italics added). Mr. Leitz goes on to do just what Dr. Shah did: crunch some numbers and make a chart. Ex. 204 (DRA/Leitz) pp. 15-16. A couple of pages later, Mr. Leitz crunches some more numbers to remove distribution costs and then makes another chart. Ex. 204 (DRA/Leitz) p. 18.

The same thing is missing from Mr. Leitz' work as is missing from Dr. Shah's written direct testimony: any indication of any verification of the costs published in an internet industry newsletter. Instead, Mr. Leitz simply directs the Commission and parties: ***For details, see referenced publication.***

Further, Dr. Shah admits the work he did and the work BoR did was different. BoR compared desalination costs specifically to the Moss Landing plan for unit costs of desalinated water, while Dr. Shah's purpose was to recommend a cost cap for desalinated water. Tr. 1478:13-21 (DRA/Shah). Dr. Shah does not explain whether this difference impacted his suggested cost cap.

These circumstances beg the questions: Upon precisely what expertise was Dr. Shah relying, and why did he rely on it?[11]

Nor does the internet newsletter to which both Dr. Shah and Mr. Leitz point provide either of them any comfort. Exhibit 364 contains damaging language Dr. Shah read from the stand:

> If softer costs—such as those related to permitting, energy, membrane replacement, chemicals, interest and local labor rates, and the period of amortization—were included, the number of possibilities grows significantly.
>
> When the impact of inflation and currency (or mix of currencies) fluctuations based is added to the mix, the inherent risk of comparing two water costs becomes obvious. All of this is based on the often (usually) incorrect assumption that the scope of the projects being considered is the same.

Ex. 364 (MCWD) p. 2; see Tr. 1501:11-1502:2 (DRA/Shah). Further:

> In many cases, the information was unofficially reported. The list could be heavily footnoted and note, for example, that the Taweelah AI price is based on an energy cost of

[11] Certainly DRA had the ability to provide stronger evidence to support Dr. Shah's and Mr. Leitz' testimony. BoR has been consulting on desalination issues with DRA since March 2007. Ex. 207 (DRA). Although the Commission does not apply formal rules of evidence, in assessing the credibility and weight to provide to Dr. Shah's testimony, the Commission may and should consider California Civil Jury Instruction 203: "You may consider the ability of each party to provide evidence. If a party provided weaker evidence when it could have provided stronger evidence, you may distrust the weaker evidence."

> $0.02/kWh. Instead, the costs are being presented with only the project's production capacity, location and the date of the price estimate to define them.

Ex. 364, (MCWD) p. 2; see Tr. 1503:1-7 (where Dr. Shah reads the first two sentences of the quote above).[12]

Thus, the very industry newsletter on which Dr. Shah and Mr. Leitz rely contains forthright cautionary statements about the value and reliability of the cost data upon which Dr. Shah would base a product water cost cap that, if adopted, very well may spell the end of this sorely-needed source of water for the Monterey Peninsula. ***These cautionary statements are nowhere to be found in Dr. Shah's or Mr. Leitz' testimony.***[13] In fact, neither expert witness attached a copy of Exhibit 364 to his testimony. Under normal circumstances, this might not raise any questions. But given the critical nature of the qualifications Exhibit 364 states concerning the desalination plant costs it lists, parties and the Commission are entitled to wonder whether the failure to attach an exhibit that is only available by subscription[14] was driven by a more sinister purpose. Without Dr. Trussell's investigation[15] and detailed cross-examination by MCWD and MCWRA, the Commission might have never learned this crucial information that two expert witnesses chose not to disclose in their testimony.

Once again, however, the ever-resourceful Dr. Shah deployed another inventive rationalization for the failure of his written testimony to discuss these cautionary statements: "the intent of my recommendation to allow the parties to come back for authorization was to account for such variances." Tr. 1551:27-28 (DRA/Shah); see generally Tr. 1551:21-28 (DRA/Shah). Dr. Shah conceded that this return to the Commission seeking further cost authorization would occur after the DRA-recommended product water cost cap was adopted. Tr. 1560:15-21 (DRA/Shah). Dr. Shah also admitted he did not consider the impact the delay caused by such a return to the Commission might have on the RDP. Tr. 1547:7-11 (DRA/Shah).

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[12] The September 22, 2010 Water Desalination Report, of which Dr. Shah was not aware in preparing his testimony, further undercut the plant cost information in Exhibit 364, noting that the cost numbers "admittedly . . . carry a lot of baggage." Exh. 365 (MCWD) p. 1; Tr. 1504:11-18; 1506:3-19 (DRA/Shah).

[13] Dr. Shah admitted this on cross-examination with respect to his testimony. Tr. 1544:15 (DRA/Shah).

[14] See Tr. 1504:20-22 (DRA/Shah).

[15] Exhibits 364 and 365 were originally attached as appendices to a Technical Memorandum from Trussell Technologies, which in turn was attached as Exhibit LWM-16 to Mr. Melton's Rebuttal Testimony, which is Exhibit 319.

Dr. Shah admits he did not include this critical alleged intent in written testimony he knew would be under oath, subject to cross-examination, and expected by parties to be complete and accurate. Tr. 1551:21-1552:1-3; 1540:18 - 1541:7 (DRA/Shah). The claim that this was Dr. Shah's and DRA's intent all along strains credulity and is entitled to no weight. DRA's recommendation is for a product water cost cap that would lead to disallowance of any Product Water costs over the cap as unreasonable, unless CAW "or Parties jointly file a separate application for recovery of such costs with a full justification for exceeding the Cost Cap, including supporting documentation of full justifications for costs both above and below" the cap. Ex. 202 (DRA/Shah) 1-7:11 - 1-8:4.

It simply makes no sense for an important explanation of intent such as Dr. Shah posits to be left out of written testimony if that were the original intent. DRA and Dr. Shah do not and never intended that variances in costs discussed in Exhibit 364 were to be accounted for under the cost cap procedure Dr. Shah suggested out-of-the-blue on the witness stand. Rather, DRA has sought a punitive cost cap, under which costs both above and below the cap could be disallowed.[16] There is only one reason for such a cost cap: to kill the RDP.

2. The February 2010 Presentation to the State Water Resources Control Board also Does not Support DRA's Cost Cap.

Dr. Shah's second justification for DRA's proposed cost cap are certain presentations made by the parties under various circumstances, most specifically a presentation made in February to the State Water Resources Control Board. Ex. 203, Att. G, 18th pg. Dr. Shah bristled with anticipation of discussing this information, repeatedly trying to wield it as both sword and shield while being cross-examined on other subjects.[17] However, once again, when the subject was directly addressed, Dr. Shah's testimony reflected little substance. He was not at the presentation. He never read a transcript of it. He may have spoken with other DRA representatives who may have attended, but did not rely on anything they said in writing his

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[16] Dr. Shah even tried to change DRA's clear testimony on disallowance above and below the cap from the stand. Dr. Shah's testimony states: "b) Disallow any Product Water costs under the Agreement above the then escalated $2200/AF as unreasonable, unless Cal Am or Parties jointly file a separate application for recovery of such costs with a full justification for exceeding the Cost Cap, including supporting documentation and full justifications for costs both above and below the $2200/AF cost cap." Ex. 202 (DRA/Shah) 1-7:11 - 1-8:4. Yet under cross-examination, Dr. Shah sought for the first time to limit the scope of such review, stating "the costs below the cap wouldn't be reviewed other than to determine precisely which ones caused the cost to exceed the cap." Tr. 1546:15-17 (DRA/Shah).

[17] See Tr. 1493:15-19; 1526:5-9; 1552:18-27; 1555:21-22; 1569:2-19 (DRA/Shah).

testimony. DRA never sent MCWRA a data request to try to determine whether its interpretation of the presentation was the same as Dr. Shah's. Tr. 1562:13 - 1563:11 (DRA/Shah). He does not know what precisely went into the presentation. Tr. 1564:1-2 (DRA/Shah).

The truth about the presentation to the SWRCB is set forth in Mr. Weeks' rebuttal testimony:

> As to the SWRCB presentation, the numbers were derived from August 2009 testimony, and the costs used there were for illustrative and comparative purposes to show differences between the costs of different projects. I certainly did not present those numbers for the purpose of creating or supporting a cost cap.

Ex. 500 (MCWRA/Weeks Rbtl) 16:19-22. This is first-hand testimony from a person who *was* there for the presentation, and is not contradicted by any testimony other than Dr. Shah's uninformed and unsupported opinions about what the presentation meant. Further, when given the chance to cross-examine Mr. Weeks about this issue, DRA asked not a single question.[18]

3. DRA's Product Water Cost Cap Will Render the Project Unfinanceable.

CAW witness Mr. Kalinovich expresses concerns about costs caps, as already discussed in Section IV.E above. Those concerns become extremely serious in the presence of a per acre foot cost cap. Mr. Kalinovich expressed the belief that a cost cap per acre foot of water would prevent the project from being financed at any reasonable interest rate. This would be a situation where an experienced construction lender would say no. Tr. 1616:4-23 (CAW/Kalinovich).

For its part, repeating a by-now-familiar theme with respect to the lack of thorough analysis DRA has brought to this vital project, DRA witness Mr. Rauschmeier admitted that before submitting testimony DRA did not consider the impact the DRA cost cap would have on financing the RDP. Tr. 1673:14-18 (DRA/Rauschmeier). This admission demonstrates yet again the lack of veracity of DRA's claim that it supports the RDP if the DRA product water cost cap is imposed. Submitting Dr. Shah's cost cap testimony without even considering the detrimental impact it would have on the ability to obtain financing for the RDP was at best sloppy, and much more likely, part of DRA's desire to see the RDP stopped in its tracks, thereby rendering useless the exhaustive efforts of the Settling Parties to develop a viable regional water source for Monterey.

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[18] DRA's cross-examination on Mr. Weeks' rebuttal testimony is at Tr. 1141:22-1148:22, and contains no questions on this topic.

4. Conclusion With Respect to DRA Cost Cap.

DRA requests the Commission modify the settlement by imposing a product water cost cap DRA cannot possibly believe will do anything other than result in a rejection of the modification and the end of the RDP. Such a cost cap would also make the RDP unfinanceable. The Commission should reject DRA's proposed cost cap.

G. <u>The Allocation of Product Water Costs under the WPA is Fair and Appropriate.</u>

1. MCWD Has no Present Need for Product Water.

As has already been explained, MCWD will utilize an agreed allocation of desalinated water within its service area, which is within the Salinas Basin, to prevent export of Salinas Basin groundwater and thus prevent violation of the Agency Act. As Mr. Collins testified, "the RDP does not proceed without MCWD." Ex. 501 (MCWRA/Collins Rbtl) 4:30. However, MCWD already has an adequate, reliable water supply for its current customers and does not presently need desalinated water. Ex. 305 (MCWD/Heitzman Rbtl) 10:26 - 11:3; ex. 319 (MCWD/Melton Rbtl) 9:10-13.

2. MCWD May Not Have Any Future Need for Product Water.

Besides not needing water at this time to serve its current customers, MCWD may actually never need Product Water from the desalination plant. Even if in the future MCWD requires further water supply for future customers such as those who may in it future locate in the former Fort Ord, MCWD has the ability to obtain potable water from groundwater and other sources. Ex. 305 (MCWD/Heitzman) 10:26 - 11:3; ex. 501 (MCWRA/Collins Rbtl) 3:31 - 4:3. Heitzman Rebuttal 10-11. Mr. Weeks explained that when the former Fort Ord and Marina Coast Water District annexed into Zones 2 and 2A, the benefit assessment district zones for Nacimiento and San Antonio reservoirs respectively, they paid $10 million to annex into those zones. One thing they got in exchange was potential additional groundwater supplies from the Salinas Basin. Mr. Weeks testified that adequate quantities exist in the Salinas Basin to meet the projected needs of the former Fort Ord. Tr. 1131:28 - 1132:26 (MCWRA/Weeks).

3. MCWD Customers Should Not Have to Pay More than the Avoided Cost of Pumped Water.

The background from the two subsections above leads into discussion of what may be the most hotly contested issue with respect to the settlement: How much should MCWD have to pay for Product Water that it takes when it does not need it? Project opponents treat the issue as a

fundamental one of fairness, but the problem with fairness is it is always in the eye of the beholder. MCWRA submits that fairness here must be measured from the perspective of the MCWD customer.

MCWD does not need Product Water now. It may never need it. It is not possible to determine now when (if ever) MCWD will need more water supply. Tr. 1128:11-17 (MCWD/Heitzman); Tr. 1252:1 - 1253:5 (MCWD/Lowrey). Even if and when MCWD ever needs more water supply, it does not have to use desalinated water as that water supply. Yet MCWD has agreed to take and utilize a certain amount of Product Water from the desalination plant so that Salinas Basin groundwater will not be exported in violation of the Agency Act.

MCWD can currently produce groundwater for delivery to its customers for $148.49 per acre foot.[19] Ex. 319 (MCWD/Melton Rbtl) 9:21-24; see also ex. 103 (CAW/Stephenson Rbtl) 23:15-26 (stating his opinion based on CAW's pumping costs that $148.49 is an accurate statement of MCWD's groundwater pumping costs). Put another way, current MCWD customers pay $148.49 per acre foot for water as a commodity and they do not need desalinated water. It would be fundamentally unfair to require them to pay more for water they do not need simply because their water supplier has elected to serve the public interest, especially the interest of CAW ratepayers, by utilizing desalinated water.

On the other hand, it is fair for CAW ratepayers to pay the difference between $148.49 and the cost of producing desalinated water for one basic reason. Given the CDO, without the RDP which in turn could not exist without MCWD's agreement to use Product Water due to Agency Act concerns, CAW ratepayers would have very little water to use, and none of it would be new water supply. DRA's position would not stop a subsidy from CAW ratepayers to MCWD customers. Instead, it would impose a subsidy from MCWD customers who have no need for desalinated water to CAW ratepayers who do.

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[19] MCWD will pay its actual costs to produce groundwater annually until the time it needs and uses Product Water to serve its customers. Those actual costs are subject to change and are verifiable and challengeable each year. Ex. 103 (CAW/Stephenson) 23:15-26; ex. 301 (MCWD) § 11.6, pp. 56-57.

H. <u>The Treatment of Legal Expenses of the Public Agencies is Appropriate.</u>

1. The Commission May and Should Allow MCWRA and MCWD to Recover Legal Expenses.

Administrative Law Judge Minkin requested parties to brief issues related to legal fees. MCWRA will explain the Commission may and should permit CAW ratepayers to reimburse the legal fees incurred by the public agencies.

As ALJ Minkin requested, MCWRA researched the issue of former Commission decisions on the issue but did not find much. The closest thing MCWRA found is Commission Resolution W-4470, from 2004. In that resolution, the Commission approved a surcharge for recovery of legal fees and other costs incurred by Del Oro Water Company in defending complaints in superior court and before the Commission concerning main extension contracts. The company prevailed in defending against the complaints. Res. W-4470, *mimeo*, p. 1, 4. The Water Division concluded recovery of the legal expenses was reasonable. The company's rate case from three years before did not authorize any allowance for recovery of legal expenses, and "[i]t was in the ratepayers' interest that the utility contested the lawsuits and CPUC complaint." *Id.* p. 3.

The major issue with respect to recovery (as opposed to accounting for) legal expenses appears to be with payment of public agency legal expenses by CAW. Once again, this dispute illustrates the impact on institutional differences between the public agencies and the Commission's regulation of privately-owned public utilities with which DRA is familiar and comfortable. DRA is used to utilities recovering their own legal fees, either because they are approved based on forecasts in general rate cases or because the Commission has allowed a utility to establish a memorandum account to track unexpected legal expenses for later recovery. In fact, in another proceeding (A.09-04-015) where the motion of CAW, MCWRA, and MCWD for approval of a Reimbursement Agreement is pending, DRA has agreed that "[a]pplicant litigation expenses are routinely approved by the Commission, . . .".[20]

However, the public agencies do not have general rate cases. They are not profit-making or loss-incurring entities. There are no shareholders to bear "disallowed costs." They must

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[20] Reply Brief of the Division of Ratepayer Advocates Opposing Certain Aspects of the Proposed Reimbursement Agreement, filed in A.09-04-015 on June 4, 2010, p. 3.

recover their costs, and in the circumstances present here, it is entirely appropriate for them to recover those costs from CAW's ratepayers.

Resolution W-4470 would seem to set up the interest of ratepayers as the test for the reasonableness of reimbursing legal expenses. In other contexts not involving legal fees specifically, the Commission has examined whether recovery of costs from ratepayers should occur because ratepayers benefited from expenditure of the costs. *Re Pacific Gas and Electric Company* (2004) Decision No. 04-03-009, *mimeo*, pp. 19-20. Under a test that considers ratepayer interest and benefit, the Commission should rule that all legal expenses for which the public agencies are to be paid under the WPA may be paid to the public agencies by CAW and recovered by it from its ratepayers.

The evidence in this case, citation to which will not be repeated here given its citation elsewhere throughout this brief, is that the RDP definitely serves the interest of CAW ratepayers. There would be no RDP without the public agencies. No other project is feasible and even if one were, it could not be completed in time for CAW to comply with the CDO, meaning CAW ratepayers would have very little water to use, not even enough to meet basic public health and safety needs. See Sections III.B & C above. The public agency costs to date have been project development costs without which there would not be a desalination project to produce water for use by CAW ratepayers. CAW ratepayers benefit substantially due to the persistence of the public agencies in sticking with the process of negotiating the WPA and SA rather than walking away, as they could have.

Addressing MCWRA specifically, CAW ratepayers benefit because MCWRA supported and helped develop the RDP, rather than fighting against it, as it could have given its obligations under the Agency Act. They benefit because MCWRA persisted during lengthy and difficult negotiations, and even during an expensive hearing process when two entities who claim to represent CAW ratepayer interests took positions that would throw the project in the same dust bin of history as every other effort to bring new water to the Peninsula. After design is completed, CAW ratepayers will benefit from the intake wells MCWRA will drill, own, and operate; without those wells, there would be no water to desalinate for the use of CAW ratepayers. They will also benefit if MCWRA must defend against challenges to the RDP. Such defense would not be to advance MCWRA's interests but those if the CAW ratepayers who will not have desalinated water if challenges to the project succeed.

Further, if the Commission does not allow recovery of legal costs, both before and after the RDP becomes operational, there is a good chance the project will fail. See ex. 500 (MCWRA/Weeks Rbtl) 19:20 - 20:1. Whatever aspersions project opponents may choose to cast, the public agencies are involved in the RDP to advance the public interest, not their own. MCWD particularly, but also MCWRA, have in essence been drafted into advancing the RDP by the Commission, and the ultimate goal is new water supply for Monterey. They have expended vast sums of money to advance the interest of CAW ratepayers and they cannot afford not to have those fees repaid. Such a result would simply be wrong.

2. There Will be a Cap on Recovery of Pre-Effective Date Legal Expenses and there are Substantive Limits on Recovery of Legal Expenses when and after the RDP becomes Operational.

DRA asserts that the WPA defines litigation costs which are uncapped. Tr. 1534:23-25 (DRA/Shah). With respect to Pre-Effective Date Costs and Expenses, DRA is incorrect, as was shown during cross-examination of Dr. Shah. Tr. 1564:25 - 1565:23 (DRA/Shah). Exhibit C to the WPA establishes the amount of the previously-discussed CPUC Settlement Cost Cap. There is a line item of $14 million on Exhibit C for Pre-Effective Date Costs and Expenses. Ex. 301 (MCWD) Ex. C. Pre-Effective Date Costs and Expenses are defined on page 18 of Ex. 301 as including "any and all of MCWD's or MCWRA's ***legal***, staff and consulting fees and expenses and any other costs or expenses incurred, prior to the Effective Date, in connection with analysis and development of a desalination project in Monterey County commencing with the Regional Urban Water Augmentation Project (not including the recycled water component thereof) and continuing through CAW's efforts to develop the Coastal Water Project." Ex. 301 (MCWD) p. 18 (bold italics added). Dr. Shah confirmed his understanding that litigation costs are part of legal costs. Tr. 1465:21-23 (DRA/Shah). Thus, Pre-Effective Date Costs and Expenses, which include litigation costs as well as many other expenses, will be capped if the Commission approves the settlement, including the CPUC Settlement Cost Cap.

This leaves the issue of litigation costs after the RDP is operational. Section 14.2 of the WPA limits the substantive scope of litigation costs that are reimbursable at that time. Such costs must be from either a claim brought by a third party that ***directly relates*** to the WPA or to the other agreements entered into by the Parties to the WPS in connection with the SA or the RDP. Among covered litigation is litigation challenging the legality or validity of the WPA or its execution or performance including, without limitation, litigation under the CEQA, the

Agency Act (other than litigation commenced by either MCWD or CAW), and inverse condemnation litigation. Ex. 301 (MCWD) § 14.2, p. 60. Thus, payment for the costs of litigation after the RDP becomes operational must be for litigation that is directly related to the RDP.

I. MCWRA Agrees to the Provision of Status Reports, which Would Require No Revisions to the WPA or SA.

On the final day of hearings, Administrative Law Judge Minkin summarized a number of areas for the parties to brief. One of those concerned status reports:

> Would the settling parties, assuming this is approved in some fashion, would the settling parties be willing to provide regular, detailed status reports to the Commission in order to keep the Commission informed as to the progress and cost of the project?

Tr. 1770:8-12 (ALJ Minkin).

Status reports going forward could encompass two time frames: the time between Commission approval and the plant commencement of commercial operations, and the time after that when the plant is operating. As to the first of these, Section 4.5 of the WPA calls for the Project Manager to submit monthly written progress reports that address a number of significant and specified areas. Ex. 301 (MCWD) § 4.5, p. 27. During the operational time period, under Section 11.13 of the WPA, CAW, in consultation with MCWRA and MCWD, is to prepare annually a Regional Desalination Project Annual Report that will be made available on CAW's website. Ex. 301 (MCWD) § 11.13, p. 59.

MCWRA would agree to CAW utilizing the Project Manager's monthly report to prepare a periodic status report to be filed with the Commission's Executive Director. MCWRA suggests that status report be filed quarterly rather than monthly, to decrease the amount of repetitive work CAW would have to perform to generate the report. MCWRA also suggests the Commission permit all or part of the status report to be filed under Public Utilities Code Section 583, as necessary and appropriate.

MCWRA would also agree to CAW providing a copy of the Regional Desalination Project Annual Report to the Commission's Executive Director at the same time it is provided to MCWRA and MCWD.

MCWRA does not believe either of these suggestions would require revision to either the WPA or SA. They are collateral implementation matters that could be addressed in the Commission's final Decision approving the settlement.

J. DRA Suggests Unnecessary Revisions that will Only Add Costs to the Project.

DRA and BoR suggested many revisions to the WPA. Among them are the addition of a pilot test and a source water contingency plan, and revisions to contractors' overhead and profit, contingencies and accuracy range of estimates. All these changes would add costs unnecessarily.

1. A Pilot Test Adds Costs and Is Unnecessary.

DRA and BoR propose a year-long pilot test for the plant. Ex. 204 (DRA/Leitz) p. 9; ex. 202 (DRA/Shah) 3-22:16-17. Mr. Melton explained that such a test is not necessary because the concerns raised by the Bureau's comments are already being addressed by the conceptual design of the Desalination Plant. The pretreatment process includes pressure filtration and chlorination to protect the reverse osmosis membranes. The design concepts will be further developed in final design of the project to incorporate water quality data from the proposed test wells. Ex. 319 (MCWD/Melton Rbtl) 29:22 - 30:4. Mr. Melton further testified he did not believe a pilot test would decrease the risks associated with desalination water production. Tr. 1190:24-27 (MCWD/Melton) Dr. Trussell also testified on cross-examination as to the lack of necessity for a pilot test, stating such a test would not help clarify the issues with respect to boron unless a new membrane comes out, and that neither pilot testing nor membrane testing are necessary. Tr. 1702:14-22; 1731:8-12 (MCWD/Trussell).

Further, a pilot plant would add a minimum of $1.5 million in capital costs according to BoR's estimate, plus an additional $8 million of escalation (at an escalation rate of 4%) due to the year delay in project implementation. Thus, a pilot plant would increase the costs of the Regional Desalination Project, not decrease them. Ex. 319 (MCWD/Melton Rbtl) 30:3-9.

The Commission should not modify the WPA to require pilot testing such as that proposed by DRA.

2. The Revisions to Contractors' Overhead and Profit, Contingencies and Accuracy Range of Estimates by BoR will Increase the Most Probable Cost by 19%.

DRA's expert the BoR recommended changing the value used for contractor's overhead and profit, contingencies, and accuracy of estimate range. Ex. 204 (DRA/Leitz) pp. 28-30. These changes would result in a significant increase in the estimated cost of the Project Facilities to be owned by MCWRA and MCWD. Taking account of all the key recommendations made by BoR, Mr. Melton calculated that the Most Probable Cost would increase from $240 million to

$286 million, an increase of 19%. The High Range of Accuracy Estimate would increase from $282 million to $422 million, an increase of 49.6%. See ex. 319 (MCWD/Melton Rbtl) 35:17 - 36:18 & Table 8. The BoR's incongruous proposal to increase the cost of the project should be rejected.

3. DRA's Proposed Source Water Contingency Plan Would be Premature, Unnecessary, and Add Costs.

DRA proposed a Source Water Contingency Plan to be overseen by WMD on page 57 of the DRA Comments. There is no need for such a plan.

First, the WPA already calls for a contingency plan for source water. The last sentence of Section 8.2(a) states provides that when test well results are available, if the parties to the WPA determine it is prudent to do so, at that time a Brackish Source Water contingency plan will be prepared by a mutually acceptable engineer. Ex. 301 (MCWD) § 8.2(a), p. 45.

Second, all the DRA plan would do is add costs to the RDP, which is a surprising position for DRA, who repeatedly claims RDP costs are too high. Waiting until after test well data is available to create such a plan is more cost-effective and also in line with other provisions of Section 8.2(a) of the WPA that require construction other than of test wells not to proceed until after MCWRA has analyzed test well data and determined whether compliance with the Agency Act will occur. Ex. 500 (MCWRA/Weeks Rbtl) 15:24-30; ex. 301 (MCWD) § 8.2(a), p. 45.

Third, DRA's plan appears to be a thin excuse by DRA to find a place in the RDP for its fellow settlement opponent WMD. WMD has nothing to do with the source water for the desalination plant and it would not be appropriate to require such a plan to include WMD oversight. Ex. 500 (MCWRA/Weeks Rbtl) 15:22-24.

This DRA suggestion should also be rejected.

V. COMPLIANCE WITH THE AGENCY ACT AND MANAGEMENT OF LITIGATION RISK.

DRA asserts there is potential litigation over water rights and CEQA issues. DRA Comments p. 37-41. The WPA contains provisions that ensure Agency Act compliance and thus minimize litigation risk.

A. **The WPA Contains Provisions Designed to Ensure Compliance with the Agency Act.**

As already discussed, the WPA is structured as it is in part to make certain Salinas Basin groundwater will not be exported. The WPA thus contains various provisions to ensure compliance with the Agency Act.

Before addressing specific provisions, the parties to the WPA took care "to recognize MCWRA's authority under the Agency Act as applicable to the Regional Desalination Project." Ex. 301 (MCWD) Recital Q, p. 3. Further, Section 8.3 on page 46 makes clear that MCWRA retains "all rights, discretion and authority to ensure both that the pumping, production, desalination, and distribution of Product Water from the Regional Desalination Project complies with the obligations and responsibilities of MCWRA under the Agency Act, and the long-term viability of the Salinas Basin as a water supply for water for agricultural, domestic and municipal use" while noting that neither "Section 8.3 nor any other provision of [the WPA] shall be interpreted either to diminish or enhance MCWRA's regulatory authority under the Agency Act, nor to preclude any argument by MCWD or CAW that there is no violation of the Agency Act."

Moving to the more specific, DRA recognizes that the WPA is structured to prevent export of Salinas Basin Groundwater. On page 15, the DRA Comments state: "If there is more than 16% Salinas Basin water in the source water, MCWRA can curtail deliveries to Cal Am to levels below 8,800 AFY to comply with the statute. Levels below 8,800 AFY could jeopardize Cal Am's ability to meet customer demand. Should the intake water wells begin drawing more than 16% Salinas Basin water, MCWRA may decide to operate the wells differently or change the well locations."

Article 8 of the WPA addresses "Brackish Source Water Supply and Management." Ex. 301 (MCWD) Art. 8, p. 44 ff. Article 8 of the WPA "is a very careful and somewhat fragile negotiation amongst a series of organizations that are trying to find a pathway to success." Tr. 1146:25-28 (MCWRA/Weeks Rbtl).

Section 8.2, found in Article 8, is entitled "Agency Act and Urban Water Management Planning," and contains several provisions designed to ensure compliance with the Agency Act both before and after construction of the RDP. Ex. 500 (MCWRA/Weeks Rbtl) 13:16-18; ex. 301 (MCWD) § 8-2, pp. 44-46.

The introductory sentence to Section 8.2 declares the WPA parties' intention to maximize the seawater content of the source water on a cost-effective basis. Ex. 301 (MCWD) § 8.2, pp.

44-45; see Tr. 1146:28 -1147:2 (MCWRA/Weeks). Maximizing seawater content assists in preventing exportation of Salinas Basin Groundwater. Ex. 500 (MCWRA/Weeks Rbtl) 13:20-21; see Tr. 1152:2 - 1153:5 (MCWRA/Weeks).

Second, Section 8.2(a) calls for the drilling of test wells. The test wells are to obtain more precise and actual data concerning the total dissolved solid and chloride levels in the source water. Ex. 500 (MCWRA/Weeks Rbtl) 13:23-24. The test wells are also intended to supplement existing analyses to provide additional information to allow a sound basis for selection of the intake well configuration. Ex. 319 (MCWD/Melton Rbtl) 32:22-24. They also will help confirm membrane performance in order to optimize the membrane design within the framework of the desalination plant. Tr. 1190:4-19 (MCWD/Melton).

Under Section 8.2(a), no authorization of construction of the RDP can occur until MCWRA provides its opinion as to whether the amount of water MCWD must use within the Salinas Basin will comply with the Agency Act. If MCWRA reasonably determines that would not occur, then the WPA parties are to meet and confer, using diligent good faith efforts, to develop a plan of action in accordance with the procedures set forth in Section 8.2(c) of the WPA. Only if they are unable to arrive at such a plan of action could the WPA possibly terminate. Ex. 500 (MCWRA/Weeks Rbtl) 13:24-30.

Third, incident to MCWRA's compliance with the Agency Act, Section 8.2(b) requires periodic monitoring by MCWRA of total dissolved solids in ocean water, source water, and inland water, as well as the elevation of the Salinas Basin. This monitoring will enable MCWRA both to be sure compliance with the Agency Act occurs and to monitor seawater intrusion.[21] Ex. 500 (MCWRA/Weeks Rbtl) 13:31 - 14:3.

Fourth, Section 8.2(c) addresses operation of the MCWRA source water wells in a fashion that will comply with the Agency Act. As noted, Section 8.2(a) requires MCWRA to make reasonable efforts to operate the source water wells so that the percentage of seawater in the source water is maximized. If MCWRA reasonably concludes based on its monitoring, testing, and measurement that the Agency Act may not be complied with, the WPA parties will

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[21] DRA suggests the Commission require any settlement to include a formula for defining both the annual and five-year average percentage of Salinas Basin water in the Source Water. DRA Comments p. 43. Determination of that information is within the jurisdiction of MCWRA under the Agency Act. The Commission lacks jurisdiction to place such a requirement into the WPA or Settlement Agreement. The WPA appropriately leaves these issues to MCWRA, in consultation with the other parties to the WPA. Because of its obligations under the Agency Act, MCWRA has every incentive to address this issue carefully and correctly.

meet and confer to determine what changes may be needed to ensure Agency Act compliance. This could include, but would not be limited to "modifying Brackish Source Water Well operations; replacing, moving, redrilling, or drilling new Brackish Source Water Wells; or determining whether curtailment of delivery of some quantity of Brackish Source Water will ensure such compliance." Curtailment of delivery is seen as the last resort, and could only be done if no other plan of action ensures compliance with the Agency Act will occur. Even then, a dispute between or among the WPA parties would proceed to dispute resolution under the dispute resolution provisions of Article 19 of the WPA. Any plan of action designed under Section 8.2 would be developed and implemented pursuant to CEQA. Ex. 500 (MCWRA/Weeks Rbtl) 14:4-17.

B. The History of MCWRA Capital Projects and Article 8 of the WPA Also Mitigate against Litigation Risk.

DRA recognizes that there are in place multiple projects designed to reduce seawater intrusion in the Salinas Basin, and expresses concern that there is a potential for litigation pertaining to water rights and environmental impacts. DRA Comments, p. 39. DRA is correct about the existence of such projects. MCWRA has developed the CSIP, the Salinas Valley Reclamation Project, and the Salinas Valley Water Project, among other projects, to address seawater intrusion in the Salinas Basin. Each of the projects mentioned has assisted and continues to assist MCWRA in bringing the Salinas Basin back into balance and slowing seawater intrusion. The protection and progress toward rebalancing of the basin made possible by those projects has led the agricultural community in the Salinas Valley, which relies on Salinas Basin groundwater, to be open to a project such as the RDP. In the past concern that water would be improperly exported from the Salinas Basin could have led to litigation and perhaps even an effort to adjudicate the Salinas Basin, which would have taken years and cost vast sums of money. Confidence in MCWRA and its commitment and ability to prevent that from occurring has led to willingness from agricultural interests to support a regional solution. Ex. 500 (MCWRA/Weeks Rbtl) 7:1-18. While litigation is still a possibility, the opinion of Mr. Weeks, MCWRA's General Manager, is that it is not the probable threat DRA seems to expect. Ex. 500 (MCWRA/Weeks Rbtl) 7:23-28.

The WPA also contains provisions to help manage the risk of litigation. The most significant potential risk of the source water wells is that seawater intrusion could be exacerbated and existing property owners and pumpers in the Salinas Basin would be harmed. The WPA

provides for a number of steps to minimize that risk. The modeling for the certified Final EIR, which is relied upon in part for the provisions of the WPA, was conducted by a renowned groundwater expert, Dennis Williams, and used modeling techniques familiar to MCWRA and the agricultural community. Ownership of the source water wells and monitoring of water both from the wells as well as from the ocean and inland sources allows MCWRA to stay on top of whether the provision of source water is having any impact on the Salinas Basin that might violate the Agency Act or exacerbate seawater intrusion. Article 8 of the WPA is designed to minimize the risk of litigation under the Agency Act by making clear MCWRA ultimately has the final say under the WPA as to whether groundwater is being exported from the Salinas Basin. Ex. 500 (MCWRA/Weeks Rbtl) 8:1-12; see also Tr. 1156:28 - 1158:3 (MCWRA/Weeks).[22] One vertical test well and one slant test will be drilled. Sections 3.2 and 8.2(c) further require CEQA compliance before any monitoring well construction as well as for any plan of action adopted under Article 8 with respect to Agency Act compliance. Ex. 500 (MCWRA/Weeks Rbtl) 8:12-17. ex. 301 (MCWD) §§ 3.2, p. 23 & 8.2(c), p. 46.

Besides the provisions to address risks under the Agency Act, the WPA contains a comprehensive overall engineering approach, set forth in Article 4 of the WPA, which is directed at minimizing the risk of construction-related litigation. Article 4 states in detail matters such as selection and duties of a Project Manager (Section 4.1, 4.2, and 4.5), use of both Value Engineering (Section 4.3(c) and a constructability review (Section 4.6), establishment of milestones for all facilities (Section 4.9), and acceptance testing (Sections 4.13 - 4.17). Ex. 500 (MCWRA/Weeks Rbtl) 8:18-23; Ex. 301 (MCWD) pp. 24-33.

C. <u>WMD'S Concerns Regarding Agency Act Compliance are Misplaced.</u>

WMD expresses concern that the portion of Product Water that must remain in the Salinas Basin could be interpreted to be the portions of the Salinas Basin Water contained in the source water. Ex. 602 (WMD/Fuerst) pp. 22-23. As the agency charged with interpreting and enforcing the Agency Act, MCWRA disagrees.[23]

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[22] As Mr. Weeks noted at this point in the transcript, the Agency Act speaks to the power of the court in some regard. Tr. 1158:12-13 (MCWRA/Weeks). Specifically, § 52-21 of the Agency Act states: "If any export of water from the [Salinas Basin] is attempted, the Agency may obtain from the superior court, and the court ***shall*** grant, injunctive relief prohibiting that exportation of groundwater." (Bold italics added.)

[23] MCWRA's interpretation of the Agency Act is entitled to deference. *Ste. Marie v. Riverside County Regional Park and Open-Space Dist* (2009) 46 Cal.4th 282, 292-93.

The method of determining the amount of water that must remain in the Salinas Basin takes account of WMD's concern. The reject brine is also part of the water that is processed at the desalination plant, and is discharged to the ocean. Because the Salinas Basin is connected hydrologically with the ocean, groundwater is discharging or seeping, under naturally occurring conditions, into the ocean over time. The rejected brine from the desalted brackish source water is also returned to the ocean. Because of the existing geology and hydrology, both components of the brine, groundwater and ocean water, are essentially returned to their natural receiving waters. Therefore, the only water that could be considered as exported out of the groundwater basin is a possible fraction of brackish source water from the Salinas Basin in the treated water delivered as drinking water to CAW, as water to MCWD is in effect a return to the Salinas Basin. This fraction is lower as the water gets more salty. Ex. 500 (MCWRA/ Weeks Rbtl) 14:19 - 15:2.

D. <u>A Declaratory Relief Action is Unnecessary and Inappropriate.</u>

DRA's solution to the perceived litigation risk is for the Commission to order the public agencies to file a declaratory relief action. DRA Comments pp. 39, 40. WMD makes a similar suggestion. Ex. 602 (WMD/Fuerst) pp. 22-23; Tr. 1320:13-26 (WMD/Fuerst).

For someone who claims it is trying to save CAW ratepayers money, DRA is awfully anxious to spend it. First, it asserts the Commission should "require the Settling Parties" to seek declaratory relief. DRA Comments, p. 40. This ignores the Commission's lack of jurisdiction to require MCWRA or MCWD to file a lawsuit. Setting aside that huge hurdle, DRA says nothing about what the cost of a declaratory relief action would be in money and notably does not state that if such an action were filed MCWRA should be allowed to recover the costs of that action from CAW ratepayers. It also says nothing about what the cost would be in terms of time. If a declaratory relief action were to be filed, it would make no sense to spend any money on the RDP until that action concluded. Further, there is the risk that such an action could morph into a basin adjudication, which would take years to resolve. Tr. 1325:11-16 (WMD/Fuerst); see ex. 500 (MCWRA/Weeks Rbtl) 7:14-16; see also DRA Comments at p. 39, where DRA admits that the Salinas Basin is not adjudicated. But perhaps most importantly, DRA demands MCWRA relinquish its jurisdiction to a court. It is MCWRA under the Agency Act that has the authority to protect the Salinas Basin and to interpret the Agency Act in doing so.

VI. THE WPA SHOULD NOT BE REVISED TO REQUIRE USE OF SLANT WELLS AS SOURCE WATER WELLS.

The WPA called for the drilling of a slant test well before the "Bureau of Reclamation Review Comments on Coastal Water Project and Alternatives Monterey, CA" (ex. 204) was ever made public.[24] See ex. 204 (DRA) p. 8. Section 8.2(a) of the WPA requires MCWRA to drill at least one slant test well. Ex. 500 (MCWRA/Weeks Rbtl) 17:5-7.

DRA ignores significant evidence, including the recommendation of its own expert the BoR, and asserts that the Commission should order **now** "that if slant wells prove feasible during the test well stage, they should be used instead of vertical wells for the intake facilities." DRA Comments, pp. 9 & 11.

This DRA position should be roundly rejected. Slant wells are too expensive and raise too many issues for any decision to be made about them until after test well data is available. See Ex. 305 (MCWD/Heitzman Rbtl) 15:26 -16:2.

DRA admits slant wells cost more than vertical wells initially. DRA Comments, p. 52. Mr. Weeks concurs, stating slant wells are far more expensive than vertical wells. Tr. 1171:16-22 (MCWRA/Weeks).

In addition, there are no slant wells that are actually providing a water supply of a project of this magnitude, meaning there are many questions about their reliability and applicability to the RDP. Tr. 1171:22-27 (MCWRA/Weeks). DRA's own expert BoR raises significant concerns about slant wells for this project, stating:

> The technology for drilling such wells may be satisfactory; however, there is not much practical experience with slant wells as a source of desalination plant feed. This technology was demonstrated one time at Dana Point at Doheny Beach in a project partially funded by Reclamation, and perhaps elsewhere. There is relatively little operating experience with slant wells. In particular, ***long term operating experience is virtually non-existent.*** Thus use of a slant well entails more technical risk than use of vertical wells; however, this risk can be considerably decreased by drilling and operating a test well in a location such that it can be used to supply part of the water for the desalination plant.

Ex. 204 (DRA/Leitz) p. 6 (bold italics added).

Mr. Melton also raised questions about slant wells related to coastal erosion. He stated "While slant well operations may be aided by adequate engineering, without better

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[24] Although Exhibit 204 is dated March 11, 2010, it was not provided to MCWRA until April 30, when it was served as part of DRA's testimony.

understanding of the performance of slant wells in this location, sediment transport and dune erosion of the magnitude exhibited in the project location pose potential uncertainty for the viability of slant wells." Ex. 319 (MCWD/Melton Rbtl) 34:5-9. He also noted "Intake evaluations in the northern portion of Monterey Bay have concluded that slant well subsurface intakes are not feasible and would become clogged during operation." Ex. 319 (MCWD/Melton Rbtl) 34:14-17.

The parties to the WPA stated their intent to maximize the intake of seawater if that can be done in a cost-effective manner. Ex. 301 (MCWD) § 8.2, pp. 44-45. But the many uncertainties surrounding slant wells compel the conclusion that any decision about whether to use slant wells and, if so, how many will be used, would be premature at this time. The Commission should reject DRA's request in this regard.

VII. VARIOUS RATEPAYER ISSUES.

A. Impact if RDP is Not Permitted or Built.

Administrative Law Judge Minkin raised the question of what "protections are in place for ratepayers to the extent, for whatever reason, the plant doesn't end up being permitted and built?" Tr. 1766:28 - 1767:2 (ALJ Minkin).

Should this occur, unless it is due to an Event of Default attributable to MCWRA, MCWRA will still be paid all its costs. MCWRA and MCWD have not tried in any way to conceal the fact that they expect to recover all the costs they have and will put into negotiating, drafting, seeking approval of, litigating over, designing, constructing, and operating a regional water solution for the Monterey Peninsula. Recital S of the WPA recites the intent of the parties to the WPA that MCWD and MCWRA will be fully paid "all the costs and expenses incurred by MCWRA and MCWD in accordance with the terms set forth herein." Ex. 301 (MCWD) Recital S, p. 3. The WPA is designed so that such payment occurs, even if the plant is not permitted or built.

Under Section 7.4 of the WPA, in such a circumstance, CAW still must reimburse each of MCWD and MCWRA for any and all costs or expenses, including Initial Capital Costs incurred in connection with the WPA, pay the cost of retiring or prepaying the Indebtedness, and forgive any CAW Financing provided under the WPA. Ex. 301 (MCWD) § 7.4, p. 43. Only if the cause of the failure of the plant to be permitted or built is directly due to an Event of Default

of MCWD or MCWRA will CAW not be obligated to pay such costs. Ex. 301 (MCWD) § 7.4, pp. 43-44.

These payment provisions are appropriate. The public agencies will not expend funds unreasonably. They are involved in the project to pursue the public interest in providing a new water supply for Monterey. They are not profit-making entities and only want to be sure their actual costs are recovered. And if the failure of the RDP to be built or permitted is due to an Event of Default of either or both of them, they will not be repaid their costs.

B. Insuring Delivery of Water to Cal-Am Customers.

Administrative Law Judge Minkin also raised the question of how CAW ratepayers can be assured that they will receive the full allocation of 8,800-acre-feet of desalinated water for which they are paying. Tr. 1766:15-17 (ALJ Minkin).

Again, the answer to this question has not been concealed in any way. The WPA requires the provision of water under it to comply with the Agency Act. The WPA is so structured because legally, it has to be. This means that, ultimately, were the percentages in the Brackish Source Water of seawater and Salinas Basin groundwater to be such that 8800 acre feet could not be delivered to CAW, CAW would not receive that much water. Ex. 301 (MCWD) § 8.2(a), p. 45; see Tr. 1258:21 - 1259:1 (MCWD/Lowrey). However, Sections 8.2(a) and (c) of the WPA also contain extensive provisions designed to make delivery of less than 8800 acre feet of water to CAW the last resort. These are summarized in Section V.A above and that summary will not be repeated here.

C. Sale of Excess Water.

Administrative Law Judge Minkin also asked whether, if CAW does not take its full allocation, water not taken could be sold. Tr. 1766:22-23 (ALJ Minkin). As Mr. Heitzman explained, "under the WPA, the parties have agreed to explore opportunities to sell either excess desalinated water or desalinated water subject to estimated transfer fees, to any interested third parties in order to further reduce the cost of desalinated water to CAW's ratepayers." Ex. 305 (MCWD/Heitzman Rbtl) 13:11-15; see WPA, ex. 301 (MCWD) § 9.5, pp. 49-50.

D. Governance Issues.

1. There is No Need to Revise the Governance Structure of the RDP.

The WPA is the core portion of the settlement. The three parties to it are CAW (who will purchase and pay for Product Water and own certain distribution facilities as well as portions of

an aquifer recovery system), MCWRA (who will own, construct, and operate the intake wells and part of the pipeline that delivers source water to the desalination plant, and ensure compliance with the Agency Act), and MCWD (who will own, construct, and operate the desalination plant, part of the pipeline that delivers source water to the desalination plant, and pipeline that delivers Product Water from the desalination plant to an interconnection with CAW's and MCWD's distribution systems; utilize an allocation of water necessary to prevent export of Salinas Basin groundwater; and dispose of brine from the desalination plant through the MRPCA outfall). See generally ex. 319 (MCWD/Melton Rbtl) 2:6-24.

The WPA carefully sets forth the obligations among and between these three parties. It includes an Advisory Committee made up of one representative of each party, and defines the duties of the Advisory Committee. See generally ex. 301 (MCWD) §§ 6.1 - 6.5, pp. 34-37.

The WPA is a complicated agreement, agreed upon only after months of delicate negotiations, and represents a fragile balance among the interests of the three parties to it. Any change in the parties to will change the careful balance its terms represent. Its implementation and operation will require vigorous cooperation among those three parties.

The principal concerns of those who want to add parties to the WPA and change its governance structure are "ratepayer representation" and, for WMD, an alleged need to be involved so it can manage its responsibilities with CAW.

Ratepayers are more than adequately represented. First, Citizens for Public Water, whom DRA recognizes as a ratepayer representative, has joined the settlement. DRA Comments, pp. 57-58.

Second, the Settling Parties understood the need for public involvement and therefore the WPA establishes the Community Involvement Forum, which will meet periodically to address issues enumerated in Section 6.7 of the WPA. Ex. 301 (MCWD) § 6.7, pp. 38-39. Each meeting of the Community Involvement Forum will be publicly noticed and open to all members of the public, press, governmental agencies, non-governmental agencies, elected and appointed officials. Ex. 301 (MCWD) §§ 6.7(d) & (f), p. 38.

Third, as described more fully in Section II.A above, MCWRA, through its Board of Supervisors, represents all citizens of Monterey County, including those within CAW's Monterey service area, which is represented by two of the five members of the MCWRA Board of Supervisors. See ex. 305 (MCWD/Heitzman Rbtl) 17:25-27 (the "Board of Supervisors of

Monterey County is also the governing Board for MCWRA and provides governance for the whole county including the Monterey Peninsula"). MCWRA follows an intensely public two-step budgeting process that is transparent and open to the public. Ex. 500 (MCWD/Weeks Rbtl) 10:12 - 11:11. Ultimately, the same as MCWD, if a member of the public is convinced MCWRA as a public agency has improperly spent funds on the RDP, it can take MCWRA to court. See ex. 361 (MCWD/Lowrey Rbtl) 5:7-9.

Fourth, while MCWD's geographic and governing scope and processes are different from MCWRA's, it is also a transparent public agency, directly accountable to its constituents and with an open, multi-step budgeting process. Its charges to its ratepayers are legally required to be reasonable and reasonably related to the cost of providing water. Its actions can be challenged in court and the ultimate check on its Board of Directors is the ballot box. See generally ex. 305 (MCWD/Heitzman Rbtl) 13:3-10; 17:4-16; ex. 361 (MCWD/Lowrey Rbtl) 3:21 - 5:25.

In short, there is no lack of "ratepayer representation" with respect to the WPA and no need to make any changes in the RDP's governance structure. Rather, what is "missing" is the "ratepayer representation" with which DRA is familiar and comfortable. However, DRA has no authority, to overturn the system of constituent representation established by the California Legislature due to a lack of comfort with that system.

The three WPA parties and in fact all parties to the settlement have demonstrated over the last year that they can work together to reach a common goal that is vital to the public interest. But as Mr. Weeks testified, the WPA reflects a fragile balance of interests. This means that not only should the substance of the settlement not be disturbed, neither should the parties who worked tirelessly and cooperatively to reach it.

2. WMD Does not Need to be Part of RDP Governance.

Although WMD claims it needs to be involved in RDP governance to carry out its statutory duties (Ex. 602 (WMD/Fuerst) pp. 20-22), that is incorrect. WMD already oversees CAW and its operations relative to the Carmel River extractions, and has no contractual obligations under the WPA. Ex. 500 (Weeks Rbtl) 18:10-12. It is not within the purview of WMD to make operational decisions of how California American Water runs the "day-to-day" operation of its facilities or to insert itself into how CAW runs its business. Ex. 105 (CAW/Schubert) 22:26 - 23:9. WMD does not review the reasonableness of CAW costs. Ex. 305 (MCWD/Heitzman Rbtl) 21:8-10.

WMD declares in its written testimony that it "has good communication with CAW and its water system operations staff and is able to anticipate changes that will affect MPWMD's environmental programs." Ex. 602 (WMD/Fuerst) p. 21. Such good communications should ensure that any necessary cooperation between CAW and WMD with respect to the RDP will occur without the need for formal involvement by WMD in the RDP. Ex. 500 (MCWRA/Weeks Rbtl) 18:29 - 19:2. In fact, during the hearing Mr. Fuerst confirmed that this cooperation would not change going forward, with or without a role for WMD on the Advisory Committee. Tr. 1418:19 - 1419:5 (WMD/Fuerst)

Thus, the record establishes that the relationship between WMD and CAW will not change under the settlement. WMD will still be able to conduct oversight of CAW. WMD does not set any rates in its service area other than its user fee; it certainly does not set CAW's customer rates for water product and delivery. There is no need for WMD to participate in the governance of the WMD, although it is welcome to participate in the Community Involvement Forum.

3. WMD is not Suited to be Part of RDP Governance.

Not only is WMD not necessary to the governance of the RDP, the unfortunate fact is WMD is ill-suited to be on the Advisory Committee or to participate in governance of the RDP. WMD is unfortunately an agency that is indecisive and ineffectual.

As was developed on the cross-examination of Mr. Fuerst, the WMD Board is conflicted as to the project. At first it took a vote to support the settlement, then a week later it reversed itself. Tr. 1315:15 - 1317:18 (WMD/Fuerst); ex. 500 (MCWRA/Weeks Rbtl) 17:28-29. Since WMD refused to participate in the settlement, it was removed from any role on the Advisory Committee. Ex. 500 (MCWRA/Weeks Rbtl) 17:29-30. Thus, it is quite clear WMD had a chance to be on the Advisory Committee and made choices that led to a different result. It now asks the Commission to rescue it from the consequences of its own dithering.

Mr. Fuerst also testified that WMD has gone through four general managers in the last ten years. Tr. 1344:24 - 1345:21 (WMD/Fuerst). Mr. Fuerst agreed that having the same General Manager over a longer period of time benefits the district and the community in which it operates. Tr. 1345:22-27 (WMD/Fuerst).

The evidence establishes that WMD has a history of ineffectual pursuit of its duties. Just with respect to the settlement, WMD insists that the agency charged with interpretation and

enforcement of the Agency Act seek declaratory relief as to Article 8 of the WPA, but does so without any written analysis of why it was necessary, without considering the impact of such a lawsuit on construction costs, and without developing any plan of action for such a suit. Tr. 1321:9 - 18 (WMD/Fuerst). WMD seeks a voting role on the Advisory Committee established by the WPA, and indeed wants to be treated as a party to the WPA, but has not determined what if any funds it is willing to spend in support of the RDP. Tr. 1329:18 - 1330:6 (WMD/Fuerst).

Further, WMD's history of successfully developing projects is uneven. Over an approximate ten year period, from 1985-1994 or 1995, WMD worked on several projects: the New San Clemente Dam Project, the New Los Padres project, a seawater desalination project to produce 3000 acre feet of water on an interim basis, and development of other areas of the Seaside Groundwater basin. The first was abandoned after a public vote of support and without seeking public input as to abandonment, which occurred due to concerns expressed by state and federal agencies. Tr. 1337:13 - 1340:5 (WMD/Fuerst). The second was abandoned for reasons that were not explained. Tr. 1339:10 - 1341:9 (WMD/Fuerst). The testimony is not clear but either the desalination project, the Seaside Groundwater Basin project, or both went to a vote and lost. See Tr. 1344:2-14 (WMD/Fuerst). During that ten-year period, WMD spent approximately $12 million on all four projects without augmenting the water supply on the Monterey Peninsula at all. Tr. 1343:17 - 1344:14 (WMD/Fuerst). In 1993, WMD did develop a new well, the Peralta well, that added 1,000 acre feet of supply. Tr. 1344: 15-20 (WMD/Fuerst). Mr. Fuerst candidly admitted that "when it came down to it," over a roughly ten-year period WMD spent $12 million to develop 1,000 acre feet of water. Tr. 1344:21-23 (WWD/Fuerst).[25]

The evidence also shows that WMD's oversight of CAW in the past could have been more vigorous. The Legislature created WMD to manage and regulate use, reuse, reclamation, and conservation of water in the Monterey Peninsula area. Ex. 602 (WMD/Fuerst) p. 16. According to Mr. Fuerst, WMD's "charge is to provide integrated water resource management over the surface and groundwater resources in the Monterey Peninsula area." Tr. 1337:10-12 (WMD/Fuerst.) Mr. Fuerst characterized WMD's powers as "fairly broad," stating "I think that we have – our authority covers almost everything within our district boundaries except for flood control." Tr. 1362:12-17 (WMD/Fuerst). Yet, despite this wide-ranging statutory charge and

[25] Compare this to MCWRA's development since 1996 of four projects with a combined financing cost in excess of $110 million. Ex. 501 (MCWRA/Collins Rbtl) 1:23-30.

authority, WMD never took any formal action with respect to CAW's excessive diversions of Carmel River water. Tr. 1341:6 - 1342:1 (WMD/Fuerst).

MCWRA would prefer not to have to be so direct and candid about a fellow public agency anywhere, let alone in its own backyard. But WMD has forced MCWRA to do so by continuing to insist on a role where first, there really isn't one, and second, even if there were, WMD is not suited to fill it. This vital project simply cannot afford to face the risk of being bogged down by an agency with WMD's uneven, ineffectual, and indecisive history.

4. WMD Cannot Own Part of the RDP.

WMD has also suggests ownership in the RDP "by an existing public agency responsible to Cal-Am ratepayers such as MPWMD." WMD Comments, p. 14. As Mr. Weeks explained in his rebuttal testimony, by agreement, WMD may not have such an ownership role. Ex. 500 (MCWRA/Weeks Rbtl) 18:8-26, and Att. CW-1 thereto, § 10, p. 3 of Agreement No. A-06181. In addition, ownership by such a public agency already exists. As discussed elsewhere in this opening brief, MCWRA's Board of Supervisors are responsible to CAW's ratepayers and answerable to them at the ballot box. Thus, this WMD request has already been met.

VIII. OTHER ISSUES.

A. DRA's Baseloading Proposal Is Unnecessary.

DRA and BoR suggest baseloading the desalination plant. Ex. 202 (DRA/Shah) 3-23:10-11; Ex. 204 (DRA/Leitz) p. 16. The RDP is to provide CAW with a replacement water supply to serve its ratepayers. Because of this, combined with the need to be certain water is used by MCWD so that export of Salinas Basin groundwater will not occur, the desalination plant will almost certainly run at full capacity most if not all the time. Further, as already addressed in Section VII.C above, if for some reason the plant does not run at full capacity, the parties have committed to try to sell excess water.

The Commission should reject this suggestion.

B. There is No Need to Revise the WPA's Provision Regarding Competitive Procurement.

DRA and BoR suggest the WPS should be revised to require three bids be sought for all construction contracts. Ex. 202 (DRA/Shah) 3-23:14; ex. 204 (DRA/Leitz) p. 17.

The WPA provides "Each of the Parties shall endeavor to obtain at least three (3) proposals from qualified contractors for each construction contract." Ex. 301 (MCWD) § 4.3(b), p. 25.

The first thing to be addressed here is nomenclature. There is a difference in government procurement between a "bid" and a "proposal." See ex. 500 (MCWRA/Weeks Rbtl) 17:11-19. Second, the parties to the WPA have committed to endeavor to get at least three competing proposals from qualified contractors for each construction contract. Any further commitment does not make sense. If only two qualified contractors are available, requiring three competitive proposals would lead either to breach of the agreement if only two proposals are sought, or to soliciting a proposal from an unqualified contractor. See ex. 500 (MCWRA/Weeks Rbtl) 11:27 - 2:3; Tr. 1569:24 - 1570:12 (DRA/Shah). Neither is an acceptable alternative.

There is no need to revise this portion of the WPA. The Commission should also reject this suggestion from DRA and BoR.

C. <u>There Is No Need to Address Various Acts Applicable to Public Agencies as WMD Demands.</u>

WMD finds fault in the WPA not addressing open meeting rules, public record rules, or ethical conduct rules. More specifically, WMD argues that the Commission should require the WPA to be revised to require Advisory Committee meetings to comply with the Brown Act, to require all records created or maintained in support of the RDP to be subject to the Public Records Act, and to require officials who make substantive decisions regarding the RDP to comply with the Fair Political Practices Act. WMD Comments, pp. 5-6.

First, WMD overlooks established law that all applicable laws in existence when an agreement is made necessarily enter into the contract and form a part of it, without any stipulation to that effect, as if they were expressly referred to and incorporated. *City of Torrance v. Workers' Comp. Appeals Board* (1982) 32 Cal.3d 371, 378; *Expansion Pointe Properties Ltd. Partnership v. Procopio, Cory, Hargreaves & Savitch, LLP* (2007) 152 Cal.App.4th 42, 56. The parties to a contract are presumed to know the applicable laws and to have had them in mind when entering into the contract. *Progressive West Ins. Co. v. Yolo County Superior Court* (2005) 135 Cal.App.4th 263, 281; *Anderson v. Time Warner Telecom of California, Inc*. (2005) 129 Cal.App.4th 411, 418. The laws referenced by WMD will, insofar as applicable, be considered to be part of the WPA.

Second, there is no need to make the revisions requested because insofar as each law is applicable, the Local Agencies will comply with them. They are governmental agencies. They are required to comply with the law. See ex. 305 (MCWD/Heitzman) 18:23 - 19:3. No covenant in a contract is necessary for the Local Agencies to do so.

This argument should be rejected.

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

The standard for approval of a settlement is set forth in Rule 12.1(d) of the Commission's Rules of Practice and Procedure, which requires a settlement to be "reasonable in light of the whole record, consistent with law, and in the public interest." DRA also cites factors set forth in the *Diablo Canyon* case, *Re Pacific Gas and Electric Company* (1988) 30 CPUC 2d 189. There, the Commission cited to then-proposed rule 51.1(e), which provided that to be approved settlements must be "reasonable in light of the whole record, consistent with law, and in the public interest."[26] *Id*. at 222. The Commission went on in that case to take note of the factors considered in assessing the fairness, adequacy, and reasonableness of class action settlements. *Id.* DRA quotes these factors in its comments on the settlement in this proceeding. DRA Comments, pp. 18-19. Among those factors are "the strength of applicant's case; the risk, expense, complexity, and likely duration of further litigation; . . .the extent to which discovery has been completed so that the opposing parties can gauge the strength and weakness of all parties; the stage of the proceedings; the experience and views of counsel; [and] the presence of a governmental participant; . . .". The Commission also considers "whether the settlement negotiations were at arm's length and without collusion; whether the major issues are addressed in the settlement; . . . and the adequacy of representation." *Re Pacific Gas and Electric Company, supra,* 30 CPUC 2d at 222; see also DRA Comments, p. 19. The settlement should be approved under either the test from Rule 12.1(d) or the *Diablo Canyon* factors.

A. Application of the Three-Part Test under Rule 12.1 Requires Approval of the Settlement.

1. The Settlement is Reasonable in Light of Whole Record and in the Public Interest.

MCWRA simultaneously addresses the first and third tests under Rule 12.1(d) because they overlap. This can be seen from the following quotation, which makes clear that in assessing whether a settlement is in the public interest, the Commission looks at the settlement as a whole:

> In reviewing a settlement we must consider individual provisions but we do not base our conclusion on whether this or that provision of the settlement is, in and itself, the optimal outcome. Instead, we stand back from the minutiae of the parties' positions and determine whether the settlement, as a whole, is in the public interest.

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[26] That proposed standard eventually was adopted and is now reflected in Rule 12.1(d).

Opinion Modifying the Proposed Settlement Agreement of PG&E (2003) D.03-12-035, *mimeo*, p. 21 (underscoring in original). In other words, while the Commission looks at the pieces of a settlement as set forth in the record, the Commission is more concerned with whether, as a whole, the settlement serves the public interest.

The record shows that RDP is an historic public-private partnership that is the only way to provide the replacement water supply CAW needs in time to comply with the CDO. The record also establishes that the project simply could not exist without the two public agencies. MCWRA must be involved to assure compliance with the Agency Act. MCWD must be involved to utilize desalinated water within the Salina Basin, meaning again, it must be involved to assure the Agency Act is not violated. Contrary to DRA's constant harping about high costs, the involvement of the two public agencies provides the possibility of low-interest tax-exempt financing, even lower-interest State Revolving Fund financing, and government agency grants to which CAW would have no or limited access. Such financing if obtained will reduce the total cost of the RDP, in turn reducing rates paid for a desalination plant for CAW ratepayers. Thus, the record as a whole establishes that involvement of MCWRA and MCWD in the RDP benefits both CAW's ratepayers and the Monterey County public.

The record is also clear that the RDP is the only available alternative that will allow CAW to timely comply with the CDO. The two other theoretical alternatives, Moss Landing and North Marina, are not feasible, whatever the time of their hypothetical development, and more expensive than the RDP. Substantial unchallenged testimony in the record proves that, without approval of the settlement and development of the RDP, economic calamity and a public health and safety nightmare will befall the Monterey Peninsula.

In addition, the record establishes that the settlement is a carefully-balanced but fragile arrangement that is both fair and equitable to the ratepayers of CAW and MCWD and the assessees and constituents of MCWRA and also provides the lowest cost solution for the Monterey Peninsula. The RDP conforms to the regional water supply project as described and analyzed in the FEIR. Further, the record contains a detailed, complete summary of costs estimates for the RDP, and at this point also includes a Unified Financing Model that can be used by the Commission in considering those costs.

Further, although MCWRA cannot address settlement discussions, such discussion is not necessary to determine that the Settling Parties all compromised substantially in reaching the

settlement. That can be determined simply by examining the provisions of the SA and WPA, both of which are part of the record.

In sum, considering the settlement as a whole and in light of the entire record, the RDP is the best available alternative – in fact, the only available alternative – to meet the Monterey Peninsula's water supply requirements, both in the short term, when it is desperately needed, and for the long term as well. The Commission may confidently find that the settlement is reasonable in light of the whole record and in the public interest.

2. Consistent with Law.

The settlement is consistent with law because it complies with the Monterey Country ordinance requiring a desalination plant to be publicly-owned[27] and because of the many provisions of the WPA designed to ensure compliance with the Agency Act. For further discussion regarding the latter point, see discussion in Section V.A. above.

B. <u>The *Diablo Canyon* Factors Also Require Approval of the Settlement.</u>

The settlement more than passes muster under the *Diablo Canyon* factors as well. The applicant's case is CAW's case, and that case is the Moss Landing project with the North Marina alternative as a back-up. As shown in Section III.C, neither project is feasible and both are more costly than the RDP. Under such circumstances, settlement is frequently in the best interests of the applicant, and that is the case here. The settlement agreement is necessary for CAW to develop an alternate water supply in time to comply with the CDO. To its immense credit, CAW worked tirelessly with MCWRA and MCWD to arrive at a regional water solution that works, but all the parties did so in arms-length, non-collusive negotiations. A review of the lengthy and complex WPA can lead to no other conclusion than that it is the product of hard bargaining by all parties and represents an agreement where significant compromise by all parties was required and was made. This matter was partially settled after this proceeding had been pending for several years, and after several months of intensive negotiations and settlement talks. Significant discovery has occurred.[28] Although the settlement is partial as to parties, the settlement resolves nearly all major issues in the proceeding. Counsel representing DRA, CAW, MCWRA, and MCWD are all counsel with lengthy experience practicing before the Commission. There are

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[27] Monterey County Code of Ordinances § 10.72.030.

[28] DRA sent out extensive and complex discovery over the years in this proceeding. MCWRA and MCWD served extensive discovery on DRA after DRA's positions regarding the proposed settlement became known. There can be no question that significant discovery has occurred in this case.

three governmental participants that are parties to the settlement: MCWRA, MCWD, and the Monterey Regional Water Pollution Control Agency. Citizens for Public Water, whom DRA recognizes as a ratepayer representative, has joined the settlement. DRA Comments, pp. 57-58. Although their presence is not among the factors to be considered, it is significant with respect to this project in which environmental concerns have been at the forefront that there are two distinct public interest groups that are parties to the settlement: Surfrider Foundation and the Public Trust Alliance.

This leaves only the issue of further litigation. If this matter returns to litigation, that litigation may be long and contentious and almost certainly will not conclude in time for CAW to comply with the CDO. And the litigation will not stop at the Commission. If the Local Agencies are not voluntary participants, they may be forced to seek judicial intervention. MCWRA might well have to litigate over Agency Act issues and if it did not, others concerned with the Agency Act or the Monterey County ordinance requiring public ownership of desalination facilities might do so. As MCWRA discusses in Section V.B. above, the WPA is structured in a way, and circumstances in the community are such, that the risk of future litigation over the RDP is mitigated. However, even if there is future civil litigation over the RDP, approval of the settlement will mean there will be no further intensive and resource-intensive litigation at the Commission.

In short, the settlement should be approved under either the Rule 12.1(d) test or the *Diablo Canyon* factors.

X. ORAL ARGUMENT.

The schedule set for the hearing on the settlement requires parties to request Final Oral Argument before the Commission in opening briefs. MCWRA does not request Final Oral Argument, but stands ready to participate in such argument should any other party or parties request it. However, time is truly of the essence here, and MCWRA urges the Commission to hold any oral argument immediately after issuance of a proposed decision.

XI. CONCLUSION.

The Commission is presented with an unprecedented opportunity that could set the stage for water regulation as well as cooperation between regulated utilities and public entities for this century. By approving the settlement, the Commission can both take a bold step into that future

and solve a long-standing water crisis in one of the most beloved regions in California. The extensive record establishes and supports the propriety of approving the settlement.

MCWRA therefore respectfully requests the Commission to approve the settlement in its present form, without modification.

Dated: July 2, 2010

Respectfully submitted,
DOWNEY BRAND LLP

By: /s/
Dan L. Carroll

Attorneys for Monterey County Water Resources Agency

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the attached:

OPENING BRIEF OF MONTEREY COUNTY WATER RESOURCES AGENCY

on all known parties to A. 04-09-019 by transmitting an e-mail message with the document attached to each party named in the official service list. I served a copy of the document on those without e-mail addresses by mailing the document by first-class mail addressed as follows, and to those specifically designated by Federal Express.

See attached service list

This service list was compiled from the service list appearing on the docket page for this proceeding on this date on the website of the California Public Utilities Commission.

Executed this 2nd day of July, 2010, at Sacramento, California.

/s/
Shawn Prentiss

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