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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

In the matter of the Application of the **GOLDEN STATE WATER COMPANY (U 133 W)** for an order authorizing it to increase rates for water service by $2,911,400 or 29.9% in 2011 and by $321,200 or 2.5% in 2012 in its Arden Cordova Service Area; to increase rates for water service by $1,782,400 or 33.2% in 2011 and by -$66,200 or -0.9% in 2012 in its Bay Point Service Area; to increase rates for water service by $409,100 or 22.6% in 2011 and by $23,300 or 1.0% in 2012 in its Clearlake Service Area; to increase rates for water service by $1,467,000 or 48.5% in 2011 and by $50,100 or 1.1% in 2012 in its Los Osos Service Area; to increase rates for water service by $1,647,900 or 38.8% in 2011 and by $343,200 or 5.9% in 2012 in its Ojai Service Area; to increase rates for water service by $2,350,700 or 25.2% in 2011 and by $363.200 or 3.1% in 2012 in its Santa Maria Service Area and; to increase rates for water service by $799,500 or 6.5% in 2011 and by $213,000 or 1.6% in 2012 in its Simi Valley Service Area.	Application 10-01-009 (Filed January 13, 2010)

JOINT MOTION FOR ADOPTION OF THE PROPOSED SETTLEMENT AGREEMENT BETWEEN GOLDEN STATE WATER COMPANY AND THE DIVISION OF WATER & AUDITS

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June 27, 2011

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

In the matter of the Application of the **GOLDEN STATE WATER COMPANY (U 133 W)** for an order authorizing it to increase rates for water service by $2,911,400 or 29.9% in 2011 and by $321,200 or 2.5% in 2012 in its Arden Cordova Service Area; to increase rates for water service by $1,782,400 or 33.2% in 2011 and by -$66,200 or -0.9% in 2012 in its Bay Point Service Area; to increase rates for water service by $409,100 or 22.6% in 2011 and by $23,300 or 1.0% in 2012 in its Clearlake Service Area; to increase rates for water service by $1,467,000 or 48.5% in 2011 and by $50,100 or 1.1% in 2012 in its Los Osos Service Area; to increase rates for water service by $1,647,900 or 38.8% in 2011 and by $343,200 or 5.9% in 2012 in its Ojai Service Area; to increase rates for water service by $2,350,700 or 25.2% in 2011 and by $363.200 or 3.1% in 2012 in its Santa Maria Service Area and; to increase rates for water service by $799,500 or 6.5% in 2011 and by $213,000 or 1.6% in 2012 in its Simi Valley Service Area.	Application 10-01-009 (Filed January 13, 2010)

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I. INTRODUCTION

Pursuant to Rule 12.1 of the California Public Utilities Commission ("Commission") Rules of Practice and Procedure ("Rules"), the Division of Water and Audits of the Commission ("DWA"), and Golden State Water Company ("GSWC") jointly submit this motion ("Joint Motion") proposing adoption of the attached settlement agreement ("Settlement").[1] DWA and GSWC (hereafter referred to as the "Signatories") have, by the Settlement, resolved all disputes

[1] The Settlement is attached as Exhibit 1 to this Joint Motion.

and issues arising from the Commission's Legal Division's ("Legal Division") and DWA's pre-formal investigation, commenced in February 2007, into GSWC's violations of the company's internal procurement policies, including violations of its internal competitive bidding requirement, when awarding various contracts to Richardson Engineering Company ("REC") for capital projects prior to January 1, 2004, and related matters.

II. THE SIGNATORIES' REPRESENTATIONS

Pursuant to Rule 12.1, the Signatories hereby represent the following:

- The Settlement commands the sponsorship of the Signatories.
- The Signatories are fairly representative of affected interests.
- The Signatories hereby provide a statement of the factual and legal considerations that are addressed in the Settlement.
- The factual background and evidence derived from Legal Division's and DWA's (hereafter referred to as "Commission Staff") pre-formal investigation set forth in the Settlement conveys sufficient information to permit the Commission to adequately deliberate on the matters addressed by the Settlement.
- The Settlement Agreement is reasonable in light of the entire record, consistent with the law, and in the public interest pursuant to Rule 12.1 (d).

III. FACTUAL BACKGROUND

A. GSWC's Internal REC Investigation

In early 2003, GSWC's senior management became aware of allegations that two of GSWC's officers had awarded contracts to REC in violation of the company's internal procurement policy's requirement for competitive bidding.[2] Nearly all of the contracts awarded were for work in Region 1.[3] In May 2003, GSWC began an internal investigation into this matter (hereafter referred to as the "REC Investigation").[4] GSWC retained the services of an outside attorney to review whether GSWC's procurement policies had been violated, an outside accountant to review the dollar amounts paid to REC, and an outside engineering firm to prepare construction estimates on a sample of REC's projects to determine whether GSWC had paid REC more than fair market value for those projects.[5]

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[2] Settlement at § 2.2.

[3] Id.

[4] Settlement at § 2.3.

[5] Id.

In October 2003, based upon an initial report by the outside attorney of his findings, GSWC terminated the employment of the two officers that it deemed most responsible for violating GSWC's procurement policy's requirement for competitive bidding when awarding contracts to REC.[6] In November 2003, GSWC's outside attorney provided GSWC with his final report. In that final report, he stated that, since the early 1990s, GSWC had awarded REC approximately 100 contracts for various projects and had paid REC in excess of $20 million. He also concluded that many of these contracts had been awarded to REC in violation of GSWC's procurement policy's competitive bidding requirement and lacked appropriate documentation.[7]

In October 2004, the outside engineering firm retained by GSWC completed its review of a sample of 22 REC contracts selected by GSWC out of approximately 100 REC contracts.[8] The 22 REC contracts comprised over half of the total dollars paid to REC.[9] The outside engineering firm concluded that six of the 22 projects exceeded the firm's estimate of fair market value.[10] However, the outside engineering firm qualified its opinion explaining that, with respect to some of these six projects, it could not determine whether REC had encountered circumstances that would have increased the costs beyond what otherwise was considered fair market value.[11]

After receiving the engineering firm's October 2004 report, GSWC evaluated whether it was obligated to report the results of its REC Investigation to the Commission, and upon the advice of its outside regulatory counsel (who is no longer advising GSWC), determined that it was not obligated to do so.[12]

B. The Commission Staff's Investigation

In February 2007, a then senior officer of GSWC met with the Commission's then General Counsel and informed him about GSWC's REC Investigation.[13] The senior officer indicated that GSWC had not disclosed the findings from its REC Investigation to the

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[6] Settlement at § 2.4.

[7] Settlement at § 2.5.

[8] Settlement at § 2.6.

[9] Id.

[10] Id.

[11] Id.

[12] Settlement at § 2.7.

[13] Settlement at § 2.8.

Commission when the company filed its Region 1 General Rate Case ("GRC") in January 2007.[14]

On February 15, 2007, Legal Division commenced a pre-formal investigation into GSWC's procurement practices related to the REC contracts by serving GSWC with a subpoena for any document related to GSWC's REC Investigation.[15] In June 2007, DWA commenced, (as part of Commission Staff's pre-formal investigation), a limited procurement examination of REC contracts awarded to REC from 1989 through 2003, a period of 15 years.[16] Commission Staff's pre-formal investigation examined whether GSWC had violated its procurement policy's competitive bidding requirement when awarding contracts to REC prior to 2004; whether improper costs associated with the REC contracts had been included in rates, resulting in harm to ratepayers ; and whether GSWC's decision not to disclose the findings from its REC Investigation at any time prior to the February 2007 subpoena had violated any Commission rule, regulation, order or other requirement or any state law.[17]

From 2007 through 2010, Commission Staff engaged in extensive discovery, including the issuance of numerous data requests resulting in the production of more than 20,000 documents, the examination under oath of several of GSWC's senior officers, and the limited procurement examination of REC contracts awarded between 1989 and 2003.[18] GSWC cooperated with Commission Staff at all times during Commission Staff's pre-formal investigation.[19]

C. Commission Staff's Investigative Findings and Recommendations

Commission Staff found evidence of the following:

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[14] Id.

[15] Settlement at § 2.9.

[16] Settlement at §§ 2.9, 2.10.

[17] Settlement at § 2.9.

[18] Settlement at § 2.10. In response to Commission Staff's information requests for its procurement examination, GSWC provided contracts and documentation dating from 1972 through 2003. Settlement at § 2.11. Commission Staff conducted an initial review and concluded that most of the work performed by, and sums paid to, REC occurred after 1989. Id. Thus, Commission Staff focused its limited procurement examination on REC contracts from 1989-2003. Id.

[19] Settlement at § 2.12.

- From 1989 through 2003, GSWC awarded approximately 100 contracts to REC amounting to approximately $20 million for projects primarily in Region 1;[20]
- Many of the REC contracts were issued in violation of GSWC's procurement policy, including lack of competitive bidding and lack of appropriate documentation;[21]
- GSWC had paid REC in excess of fair market value for several of the REC contracts;[22] and
- During and after GSWC's REC Investigation, GSWC continued to file applications that included what Commission Staff found to be excess costs associated with the REC contracts in ratebase (A.03-10-057, A.04-08-042, A.05-02-004, A.07-01-009, and, most recently, A.10-01-009) without disclosing the findings from its REC Investigation to the Commission at any time prior to the Commission's 2007 subpoena.[23]

Commission Staff also found evidence that, for a period of 21 years (1989-2010), GSWC included $23.7 million of REC costs in calculations affecting rates. The $23.7 million is comprised of $16.4 million of REC contracts, GSWC's overhead related to work on the REC projects, and GSWC's direct labor that went into ratebase, and $7.3 million of the same related to the Arden-Cordova Memorandum Account.[24]

Commission Staff determined that GSWC's inclusion of the $23.7 million in the calculation of rates has exposed GSWC's customers to unjust and unreasonable charges and up to $31 million of past ratepayer harm.[25] To redress this harm, Commission Staff recommended that GSWC issue a surcredit to ratepayers.[26] To prevent future ratepayer harm from these same costs, Commission Staff recommended adjusting existing ratebase by up to $8 million and

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[20] Settlement at § 3.1.

[21] Id.

[22] Id.

[23] Settlement at § 3.2.

[24] Settlement at § 3.3.

[25] Settlement at § 3.4.

[26] Settlement at § 3.5.

adjusting the Arden-Cordova Memorandum Account by up to $700,000.[27] Commission Staff points out that these figures are based on a 100% disallowance of the REC costs, including overhead and direct labor. Commission Staff also found that GSWC was obligated to disclose the results of GSWC's REC Investigation to the Commission, and its customers were exposed to unjust and unreasonable rates because GSWC failed to do so.[28] Commission Staff has recommended that GSWC be penalized pursuant to Public Utilities Code Sections 2107-2114.[29]

D. GSWC's Positions with Respect to Commission Staff's Investigative Findings and Recommendations

GSWC disagreed with Commission Staff's findings and conclusions both with respect to ratemaking and more generally, and believed that the weight of the evidence supports GSWC's view with respect to the issues raised by Commission Staff's pre-formal investigation.[30] GSWC disputed Commission Staff's findings and calculations regarding harm to ratepayers.[31] Among other things, GSWC disputed Commission Staff's findings that the failure to comply with GSWC's internal procurement policy necessarily resulted in harm to ratepayers,[32] and that customer rates have been impacted by excess costs associated with REC contracts.[33]

GSWC concluded that REC completed many construction projects competently and at reasonable cost, and in some cases, in response to what GSWC found to have been exigent circumstances.[34] Many of the projects completed by REC remain in service to this day.[35]

GSWC disputed that it was under any duty to disclose the findings of its REC Investigation to the Commission.[36]

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[27] Settlement at § 3.6.

[28] Settlement at § 3.8.

[29] Settlement at § 3.9.

[30] Settlement at § 4.1.

[31] Settlement at § 4.2.

[32] Id.

[33] Settlement at § 4.4.

[34] Settlement at § 4.3.

[35] Id.

[36] Settlement at § 4.5.

IV. PROCEDURAL BACKGROUND

GSWC's original Application 10-01-009 ("A.10-09-001") in this proceeding was accepted as filed on January 13, 2010, and amended by GSWC on January 27, 2010.[37] On February 26, 2010, the Division of Ratepayer Advocates ("DRA") filed a protest addressing various issues associated with the rate increases proposed in A.10-01-009 and identifying Commission Staff's pre-formal investigation as an open issue to be acknowledged in this proceeding.[38] GSWC replied to DRA's protest on March 8, 2010.[39]

On March 11, 2010, the assigned Commissioner and Administrative Law Judge issued a Scoping Memo for this proceeding. The Scoping Memo acknowledges Commission Staff's pre-formal investigation and states that any improper costs could be addressed in a future formal investigation if the Commission deemed such an investigation was warranted.[40]

On December 20, 2010, the Commission issued Decision 10-12-059, which addressed most of the issues raised in this proceeding, A.10-01-009, but left the proceeding open to address unresolved issues.

Concurrent with the Commission's consideration of A.10-01-009, DWA and GSWC worked to resolve the issues raised by Commission Staff's pre-formal investigation. DWA and GSWC held several settlement conferences beginning in June 2010, and continued to have settlement discussions for several months.[41] On November 16 and 17, 2010, they participated in a two-day mediation session under the Commission's alternative dispute resolution program and reached a settlement in principle.[42]

The Settlement terms, specified below, include GSWC's agreement to refund customers in the form of a surcredit to address Commission Staff's findings about past ratepayer harm, and to adjust both existing ratebase and the balance in the Arden-Cordova Memorandum Account to prevent any future ratepayer harm. Because over 92% of the refunds that GSWC will issue

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[37] Decision 10-12-059 at 26.

[38] See, generally, Protest of the Division of Ratepayer Advocates in A.10-01-009 (Feb. 26, 2010) (hereinafter "DRA Protest").

[39] See, generally, Golden State Water Company's Reply to the Protest of the Division of Ratepayer Advocates in A.10-01-009 (Mar. 8, 2010).

[40] Assigned Commissioner and Administrative Law Judge's Scoping Memo and Ruling (Mar. 11, 2010) at 6 (hereinafter "Scoping Memo").

[41] Settlement at § 5.1.

[42] Id.

under the Settlement will be amortized in the rates of customers in GSWC's Region 1 customer service areas and GSWC will make rate base adjustments in all Region 1 customer services areas, the issues resolved in the Settlement are within the scope of this Region 1 GRC.

Hence, on March 30, 2011, DWA filed a Motion for Party Status in this proceeding. On April 22, 2011, the Commission granted DWA's Motion for Party Status and required GSWC to notify all customers in Region 1, and every county, city attorney and city manager in Region 1, of the proposed settlement and settlement conference.[43] The Commission determined that, pursuant to Rule 1.4, anyone who receives notice of the proposed settlement may apply for party status, and that the settlement conference may not be conducted with less than 28 days' notice to the aforementioned persons and entities.[44] On May 25, 2011, GSWC provided a Commission approved notice of the proposed settlement and settlement conference to all customers and to every county, city attorney and city manager in Region 1. On June 8, 2011 the City of Ojai filed a protest in this proceeding and was made a party to this proceeding by ruling of the assigned administrative law judge. On June 17, 2011, DWA and GSWC served notice of an official Rule 12.1(b) settlement conference for June 28, 2011. A revised notice was served on June 20 changing the date for the settlement conference to June 27, 2011. Representatives of DWA and GSWC attended the settlement conference, and representatives of DWA and GSWC signed the Settlement on June 27, 2011 following the settlement conference. .

V. SUMMARY OF THE SETTLEMENT TERMS

A. Section 1: Terms and Conditions – General

Section 1 of the Settlement provides the general terms and conditions of the Settlement, including identifying DWA and GSWC as the Signatories to the Settlement;[45] setting forth in which respects the Settlement is binding;[46] explaining that the Settlement shall not result in personal liability;[47] identifying the Commission as the entity with primary jurisdiction over

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[43] Modified Scoping Memorandum of the Assigned Commissioner Extending Time, and a Ruling Granting Party Status to the Division of Water and Audits, and also Requiring Adequate Notice of a Proposed Settlement (Apr. 22, 2011) (hereinafter "Modified Scoping Memo") at 5-6.

[44] Id. at 6.

[45] Settlement at § 1.1.

[46] Settlement at §§ 1.2, 1.13.

[47] Settlement at § 1.3.

interpretation of, enforcement of, or remedies pertaining to the Settlement;[48] and so forth. Section 1 also identifies those provisions that are effective upon execution of the Settlement, which may be rescinded under certain circumstances (as described in the discussion of Section 10 below), and identifies those provisions that will become effective only upon the Commission's approval of the Settlement, which approval becomes final and no longer subject to appeal (hereafter referred to as "Commission Approval").[49] Specifically, the remedies and audits to which GSWC has agreed under Sections 6 and 7 of the Settlement, respectively, and the release of claims arising from or related to Commission Staff's pre-formal investigation set forth in Section 9 of the Settlement, will become effective only upon Commission Approval.

B. Section 2: Factual Background

Section 2 of the Settlement sets forth the factual background resulting in the Signatories executing the Settlement on June 27, 2011. This information has been incorporated into the factual background set forth above in Section III.A and Section III.B of this Joint Motion: "GSWC's Internal REC Investigation" and "The Commission Staff's Investigation," respectively.

C. Section 3: Commission Staff's Investigative Findings and Recommendations

Section 3 of the Settlement sets forth Commission Staff's findings resulting from its pre-formal investigation and its recommendations based on those findings. This information has been incorporated into the factual background set forth above in Section III.C of this Joint Motion: "Commission Staff's Investigative Findings and Recommendations."

D. Section 4: GSWC's Response to Commission Staff's Investigative Findings

Section 4 of the Settlement sets forth GSWC's positions with respect to Commission Staff's investigative findings and recommendations. This information has been incorporated into the factual background set forth above in Section III.D of this Joint Motion: "GSWC's Positions with Respect to Commission Staff's Investigative Findings and Recommendations."

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[48] Settlement at § 1.4.

[49] Settlement at § 1.16.

E. Section 5: Discussions between GSWC and DWA Staff Regarding Settlement

Section 5.1 provides the history of the Signatories' negotiations resulting in the Settlement, information which has been incorporated into the procedural background set forth above in Section IV of this Joint Motion. Section 5.2 sets forth certain critical aspects of the Signatories' agreement. Specifically, it explains that, for the sole purpose of the Commission's consideration of the Settlement, GSWC has agreed not to dispute (i) that it had a duty to disclose the result of its REC Investigation to the Commission, (ii) that it failed to fulfill this duty and (iii) that ratepayers were exposed to unjust and unreasonable costs in their water rates as a result. However, if the Commission does not approve the Settlement in its entirety and without modification, then GSWC is entitled to contest all of the foregoing, as well as any findings of Commission Staff, including those set forth in Section 3 of the Settlement.

F. Section 6: Terms and Conditions – Remedies

Section 6 sets forth the remedial actions to which GSWC has agreed under the Settlement.

Under Section 6.1.A, within 30 days after Commission Approval of the Settlement, GSWC will file a Tier 1 Advice Letter to initiate customer refunds of previously collected revenues associated with REC payments. GSWC shall apportion $9.5 million in refunds across GSWC's seven Region 1 ratemaking areas, and across Regions 2 and 3, as follows:

- Arden-Cordova: $ 3,578,522 (36-month amortization)
- Bay Point: $ 1,556,435 (36-month amortization)
- Clearlake: $ 1,437,211 (36-month amortization)
- Los Osos: $ 33,983 (12-month amortization)
- Ojai: $ 986,463 (36-month amortization)
- Santa Maria: $ 192,566 (12-month amortization)
- Simi Valley: $ 993,167 (24-month amortization)
- Region 2: $ 322,325 (12-month amortization)
- Region 3: $ 399,328 (12-month amortization)

Section 6.1.B sets forth that the refunds will be provided through surcredits in monthly bills, and that GSWC shall establish a balancing account for each of the districts for refunding the amounts enumerated above. Amounts in these balancing accounts will earn interest at the

90-Day Commercial Paper Rate, and GSWC will track the money refunded through surcredits in the balancing accounts, report balances to the Director of DWA, and propose a methodology for addressing any balance remaining at the end of the period for amortizing each account.

Section 6.2 provides that within 30 days after Commission Approval, GSWC will file a Tier 2 rate base offset advice letter to reduce rates associated with a reduction in its recorded rate base by $2.5 million. GSWC shall apportion the $2.5 million reduction across its ratemaking areas as follows:

- Arden-Cordova: $ 1,241,460
- Bay Point: $ 299,587
- Clearlake: $ 266,684
- Los Osos: $ 17,841
- Ojai: $ 250,651
- Santa Maria: $ 98,265
- Simi Valley: $ 267,457
- Region 3: $ 58,055

Section 6.3 provides that within 30 days after Commission Approval, GSWC will file a Tier 1 Advice Letter reflecting the reduction of the balance in the existing Arden-Cordova Memorandum Account by $500,000, and reducing the surcharge proportionately.

Commission Staff found that the past ratepayer harm associated with REC costs already collected in rates was up to approximately $31 million.[50] This $31 million figure would have involved a 100% disallowance of GSWC's payments to REC, GSWC's internal overhead and direct labor, and GSWC's return on ratebase associated with the REC projects. GSWC disputed Commission Staff's findings and calculations and concluded that REC completed many construction projects in a competent manner and at reasonable cost and, in some cases, under exigent circumstances.[51] The Signatories have agreed that the $9.5 million in refunds, nearly one-third of Commission Staff's estimated maximum liability, is a fair and reasonable compromise of what DWA has deemed past ratepayer harm.

Commission Staff found that adjusting existing rate base by a maximum of $8 million, and adjusting the Arden-Cordova Memorandum Account by a maximum of $700,000, would

[50] Settlement at § 3.4.

[51] Settlement at §§ 4.2, 4.3.

prevent future harm to ratepayers from the same REC and GSWC costs.[52] Again, these figures were based on a 100% disallowance of these same costs. Although GSWC disputed Commission Staff's findings and calculations, and whether the REC contracts exceeded fair market value, GSWC has nonetheless agreed to adjust existing rate base by $2.5 million, nearly one-third of Commission Staff's estimated maximum liability, and to adjust the Arden-Cordova Memorandum Account by $500,000, over two-thirds of Commission Staff's estimated maximum liability. The Signatories have agreed that the $2.5 million adjustment is a fair and reasonable compromise and will prevent continuing and future ratepayer harm resulting from these same REC costs.

While it is GSWC's position that $12.5 million significantly exceeds any possible ratepayer harm associated with the REC and related GSWC costs, GSWC has agreed to pay this $12.5 million in order to avoid the costs and uncertainty of litigation over these matters, to put the past behind it, and to facilitate an open and constructive relationship with the Commission in the future. DWA acknowledges that the $12.5 million represents a fair compromise in light of the cost and uncertainty associated with litigation. Hence, DWA and GSWC agree that the $12.5 million remedy provides fair relief for any harm that may have been caused by the costs associated with the REC contracts.

Section 6.4 addresses DWA's concern that GSWC had a duty to disclose, and failed to disclose, its REC Investigation to the Commission. Under this section, within 30 days after Commission Approval, GSWC will pay a $1 million penalty to the General Fund of the State of California. GSWC has consented to this remedy in accordance with its agreement not to dispute, for the purpose of the Settlement, that it had a duty to disclose its REC Investigation to the Commission, to avert the costs and uncertainty of litigation, and to move forward with the Commission in good standing.

Section 6.5.A explains that GSWC has agreed not to include any and all legal, investigation or other expenses incurred in connection with its REC Investigation and Commission Staff's pre-formal investigation in its historical expense figures for the purpose of determining its expenses for any future rates.

Section 6.5.B explains that, with respect to any future filings with the Commission, GSWC has agreed to identify separately any and all litigation costs, investigation costs, and other

[52] Settlement at § 3.6.

expenses it incurred in connection with any civil litigation arising out of or related to its REC Investigation prior to the date of this Settlement that are included in GSWC's historical expenses for the purpose of determining its expenses in any future filings. GSWC has also agreed to identify any and all such costs and/or expenses in a separate paragraph with a reference to the Commission's Decision approving this Settlement. As such, these provisions further ensure that GSWC's customers will not be negatively impacted by costs related to the REC contracts in the future.

G. Section 7: Terms and Conditions – Future Audits

In order to ensure that a similar pattern of procurement policy violations, (akin to the REC contracts), has not occurred or does not continue to occur in connection with other contractors in or outside of Region 1, Section 7 provides a means to determine whether ratepayers have been exposed to potentially excessive costs as a result of other significant non-compliance with GSWC's procurement policies so that such harm, if any, can be addressed.

Under Section 7.1, GSWC has agreed to be subject to three separate independent audits of its procurement practices for engineering or construction for any and all capital projects starting in 1994[53] over a ten-year period from the date that the Commission approves the Settlement. Section 7.2 explains that the audits will examine GSWC's compliance with Commission and GSWC policies and procedures for the procurement of outside engineering or construction contracts for capital projects in its Region 1, Region 2, Region 3, and General Office. Should any violations of such policies be found, the offending contracts will be identified and their impact on rates quantified. These audits will exclude REC contracts executed prior to January 1, 2004 as these contracts were already reviewed by Commission Staff as part of its initial procurement review, with the exception of any REC contracts that GSWC intentionally failed to disclose to Commission Staff during its pre-formal investigation, if any. Section 7.3 states that DWA will contract for the services of an independent auditor pursuant to the requirements set forth in California's State Contracting Manual and California's Public Contract Code, as well as any other applicable statute, rule, or regulation, to conduct the

[53] 1994 was selected as the start date for the audits because, in 1994, GSWC implemented an electronic records system that will facilitate the review of GSWC's procurement decisions. DWA and GSWC agree that reviewing records prior to the date that the electronic system was implemented would be overly-burdensome, and that a review period of nearly three decades (looking back at least seventeen years and forward ten years), is sufficient to ensure compliance with GSWC's procurement policies.

aforementioned three audits. Section 7.4 explains that DWA has agreed, to the extent permitted by California's State Contracting Manual and California's Public Contract Code, to consult with GSWC prior to issuing its Request for Proposals ("RFP") for each auditor, regarding appropriate selection criteria and scope of work to be included in the RFP. Section 7.5 explains that GSWC has agreed to pay the costs of each audit and not to seek recovery of these costs from its customers at any time. Section 7.5 also provides the recourse to be followed if GSWC reasonably believes that the auditor is exceeding the scope of the audit or incurring excessive costs.

Section 7.6 explains that the Commission's Fiscal Office will invoice GSWC for the audit costs by mail and will include a letter setting forth the payment due date. Section 7.7 states that, subject to attorney-client and attorney-work-product privileges, GSWC will provide the independent auditor with any document requested that is within the scope of the audit, including copies of GSWC's past, present and future procurement policies.

Sections 7.8 through 7.13 explain the issues that will be addressed in each of the three audit reports to be produced by the independent auditor, and delineates that the audits will review the period from 1994 through the date that is ten years after Commission Approval of the Settlement; it also specifies the procedures for issuing these reports, including GSWC's ability to review the reports and provide comments to the independent auditor; and the approximate timing for the issuance of each report. These sections also explain that, within one week of the completion of each of the three reports, copies will be provided, on a confidential basis, to GSWC, the Director of DWA, the Director of DRA, the Commission's General Counsel, and the supervisor of Legal Division's Water Section.

Section 7.14 explains that within 30 days of issuance of each audit report, GSWC and DWA will meet to discuss whether GSWC needs to take any action. If, within 30 days of their first meeting, DWA and GSWC are unable to agree upon the action required, then DWA and GSWC will be free to take whatever action it deems necessary.

H. Section 8: Terms and Conditions – Confidentiality

Sections 8.1 through 8.4 sets forth the Signatories' agreement regarding confidentiality, including, but not limited to, ensuring that all negotiations and communications made during the course of discussions are subject to Rule 12.6, and that all documents submitted by GSWC to Commission Staff during Commission Staff's pre-formal investigation, any documents provided

by GSWC to an independent auditor pursuant to Section 7 of the Settlement, and any audit reports or other documents produced by an independent auditor to the Commission in accordance with Section 7 of the Settlement, shall be deemed confidential pursuant to Section 583 of the California Public Utilities Code. Each of these provisions is consistent with the Commission's General Order No. 66-C, which includes records of investigations and audits made by the Commission among those records not open to public inspection.[54]

I. Section 9: Terms and Conditions – Resolution and Release

Section 9 sets forth the Signatories' agreement that all disputes related to or arising from Commission Staff's pre-formal investigation are finally and conclusively resolved by the Settlement, except as provided in Section 9.2. Section 9.2 explains that the general release set forth in Section 9.1 does not include claims related to (i) REC contracts that GSWC intentionally failed to disclose during Commission Staff's pre-formal investigation; (ii) any REC contracts entered into by GSWC in Region 1, Region 2, Region 3, and/or General Office after December 31, 2003, or (iii) any contract that is the subject of the future audits to be undertaken pursuant to Section 7 of the Settlement.

J. Section 10: Terms and Conditions – Approval by the Commission

Sections 10.1 through 10.5 set forth the Signatories' agreement with respect to seeking Commission approval of the Settlement, including but not limited to, the Signatories' obligation to support and defend the Settlement and use their best efforts to secure the Commission's approval of the Settlement in its entirety without condition or modification, GSWC's option to terminate the Settlement if the Commission decides to go forward with discovery, testimony, or hearings on this Settlement, and, without limiting this termination right, the Signatories' agreement to meet and confer about any conditions or modifications to the Settlement ordered by the Commission prior to rescission.

One of the primary benefits to be achieved by GSWC as a result of the Settlement is the avoidance of litigation concerning the matters addressed by the Settlement. This includes avoidance of the costs of litigation, the uncertainty of the outcome, the diversion of company

[54] See General Order No. 66-C at 2.2(a) which states: "Public records not open to public inspection include . . . Records of investigations and audits made by the Commission, except to the extent disclosed at a hearing or by formal Commission action."

resources and the adverse nature of the proceeding. If, however, discovery, testimony or hearings are permitted, this key benefit to GSWC will not be realized. As such, the Settlement provides the Section 10.2 termination right to GSWC in the event that litigation concerning the matters addressed by the Settlement ensues.

K. Section 11 and Section 12: Governing Law and Conclusion

Section 11.1 explains that California law governs the Settlement as to all matters, including validity, construction, effect, performance and remedy, and Section 12.1 sets forth the Signatories' mutual belief that the Settlement is reasonable, consistent with law, and in the public interest.

VI. THE SETTLEMENT AGREEMENT IS REASONABLE, CONSISTENT WITH THE LAW, AND IN THE PUBLIC INTEREST

A. The Settlement is Consistent with the Law

The Settlement complies with all applicable statutes and prior Commission decisions.

B. The Settlement is Reasonable in Light of the Record

Rule 12.1 requires that a settlement be "reasonable in light of the whole record, consistent with law, and in the public interest." The proposed Settlement readily meets all of these criteria.

As described in detail above, the terms of the Settlement present a reasonable and comprehensive resolution of all issues arising from Commission Staff's pre-formal investigation. Given the breadth of that pre-formal investigation, including GSWC's full cooperation with Commission Staff over the course of more than three years, and the disclosure of over 20,000 documents, DWA entered into the Settlement after fully examining all pertinent facts and legal questions. Moreover, DWA and GSWC worked diligently through many months of negotiations and also engaged in the Commission's mediation procedures to further ensure that their settlement efforts would result in a reasonable and fair settlement of the harms that DWA asserts resulted from the REC contracts.

The Signatories emphasize that Commission Staff's pre-formal investigation lasted for over three years and thoroughly examined all facts and legal issues related to the subject matter of the Settlement. While formal testimony has not been provided in support of the Settlement, Commission precedent supports approval of a settlement so long as the settlement agreement is closely based on the record developed by the parties or directly addresses alleged harms, as is

and does the Settlement.[55] As such, the Settlement meets the criteria for a Commission determination that the Settlement is reasonable in light of the whole record.

C. The Settlement is in the Public Interest

The Commission has held that a settlement that "commands broad support among participants fairly reflective of the affected interests" and "does not contain terms which contravene statutory provisions or prior Commission decisions" serves the public interest.[56] With respect to the issues raised by Commission Staff's pre-formal investigation, the Settlement is clearly in the public interest.

First, GSWC has agreed to economic remedies that will provide substantial benefits to its customers, as set forth above, in Section 6 of the Settlement. Second, the audits to which GSWC has agreed will identify any other potentially significant violations of GSWC's procurement policies with respect to any other contractors or in any other regions since 1994 and will safeguard against any similar non-compliance in the future. Moreover, GSWC has agreed that its customers will not bear the costs of these audits. Third, in order to settle its dispute with DWA regarding whether it had an obligation to timely disclose its REC Investigation to the Commission, GSWC has agreed to pay a $1 million penalty to the General Fund of the State of California.

Further, the Commission has expressed a "strong public policy" in favor of settlements.[57] As the Commission has recently stated:

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[55] See Pac. Gas and Elec. Co. v. Calpine Corp., Decision 04-07-006, 2004 WL 1857151 (Cal.P.U.C.) at *6 (approving a settlement agreement without the evidentiary hearings that the administrative law judge determined would be necessary; explaining "the Settlement Agreement is very closely based on the record developed by the parties, and is reasonable because it addresses the specific issues raised in the complaint"); see, also, Re Inter Cont. Tel. Corp. v. Cal. Pub. Util. Com'n, Decision 98-03-067, 1998 WL 1750050 (Cal.P.U.C.) at *2 (approving a settlement agreement in an investigatory proceeding ordered by the Commission before the investigation was ever conducted; explaining that the settlement was specially tailored to address the allegations made and that "the burdens on ICT reasonably address the harms to which this proceeding was directed").

[56] Re San Diego Gas & Elec., Decision 92-12-019, 46 CPUC 2d 538, 552.

[57] Decision 05-03-022.

> This strong public policy favoring settlements weighs in favor of our resisting the temptation to alter the results of the negotiation process. As long as a settlement taken as a whole is reasonable in light of the record, consistent with the law, and in the public interest it should be adopted.[58]

Here, Commission approval of the Settlement in its entirety, without conditions or modification, will provide for the speedy resolution of contested issues, will save unnecessary litigation expenses, will conserve Commission resources and will result in economic benefits timely accruing to GSWC's customers.

For each of the foregoing reasons, the Settlement is consistent with Commission precedent, does not contravene statutory law and is in the public interest. Therefore, the Commission should approve the Settlement.

VII. DWA AND GSWC HAVE COMPLIED WITH THE REQUIREMENTS OF RULE 12.1(B)

Commission Rule 12.1(b) requires parties to provide a notice of a settlement conference at least seven days before a settlement is signed. On June 20, 2011, DWA and GSWC notified all of the parties on the service list in these proceedings and the City of Ojai and subsequently convened the settlement conference on June 27, 2011 to describe and discuss the terms of the proposed Settlement. Representatives of DWA and GSWC participated in the settlement conference. The Settlement was finalized and executed on June 27, 2011 following the settlement conference.

VIII. THE COMMISSION SHOULD WAIVE THE FILING DEADLINE SET FORTH IN RULE 12.1(A)

Under Rule 12.1(a), a motion proposing a settlement resolving any material issue of law or fact must be filed within thirty days of the last hearing date. DWA and GSWC acknowledge that the last evidentiary hearing in this proceeding was held on June 22, 2010, and, therefore, the Rule 12.1(a) deadline has passed. DWA and GSWC, therefore, respectfully ask the Commission to exercise its discretion under Rule 1.2 and permit a deviation from Rule 12.1(a). Rule 1.2 explains that the Commission may permit deviations from the Rules in special cases and for good cause shown. In this case, DWA and GSWC did not reach a settlement in principle with respect to Commission Staff's pre-formal investigation until November 17, 2010, well after the

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[58] Id. (citing Decision 92-12-019, 46 CPUC 2d 538, 553).

Rule 12.1(a) deadline. However, the time spent negotiating the Settlement provided DWA an opportunity to thoroughly examine all issues related to the REC contracts. Further, DWA and GSWC have otherwise expended significant resources in their settlement efforts, which, as discussed above, have resulted in a reasonable and fair settlement of all issues related to or arising from the REC contracts executed prior to January 1, 2004. As such, the Commission has good cause to hear this Joint Motion and to grant the relief requested herein, notwithstanding the late filing date.

IX. THE COMMISSION SHOULD EXPEDITIOUSLY APPROVE THE SETTLEMENT

As discussed in detail above, GSWC's customers will benefit from the refunds and rate base adjustments agreed to in the Settlement, and DWA and GSWC intend for these benefits to accrue as soon as possible. As such, DWA and GSWC respectfully request that the Commission expeditiously consider and approve the Settlement, without condition or modification, and issue a decision within 90 days.

X. CONCLUSION

In light of the foregoing, the Settlement is reasonable in light of the whole record, consistent with law, in the public interest, and DWA and GSWC have shown good cause for their other requests related to approval of the Settlement. Thus, DWA and GSWC respectfully request that the Commission approves the Settlement in its entirety without modification or

condition within 90 days; approves the Settlement without holding a pre-hearing conference or permitting discovery, testimony or hearings, and waives the filing deadline set forth in Section 12.1(a).

Dated: June 27, 2011

Respectfully submitted,

/s/ Maria L. Bondonno

DIVISION OF WATER AND AUDITS
OF THE CALIFORNIA PUBLIC UTILITIES
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/s/ Joseph M. Karp

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Exhibit 1

SETTLEMENT AGREEMENT BETWEEN GOLDEN STATE WATER COMPANY AND THE DIVISION OF WATER AND AUDITS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION

1. TERMS AND CONDITIONS – GENERAL

1.1. This Settlement Agreement ("Settlement") is entered into by Golden State Water Company ("GSWC") and the Division of Water and Audits ("DWA") of the California Public Utilities Commission ("Commission"). GSWC and DWA are referred to jointly herein as the "Signatories" or singularly as a "Signatory." The Signatories have addressed the issues referred to herein and have negotiated this Settlement to resolve their disputes.

1.2. The Signatories agree that, except for Section 9 below, the Commission's adoption of this Settlement should not be construed as an admission or waiver by any Signatory regarding any fact, matter of law, or issue thereof that pertains to the subject of this Settlement. In accordance with the Commission's Rules of Practice and Procedure, Rule 12.5, the Signatories intend that the Commission's adoption of this Settlement be binding on each Signatory, including its legal successors, predecessors, assigns, partners, joint ventures, shareholders, members, representatives, agents, attorneys, parent or subsidiary companies, affiliates, officers, directors, and/or employees. Without limiting the effect of Section 9 adoption of this Settlement does not constitute approval of, or precedent regarding, any principle in any future proceeding, unless the Commission expressly provides otherwise.

1.3. The Signatories agree that no signatory to this Settlement, or any Signatory's legal successors, predecessors, assigns, partners, joint ventures, shareholders, members, representatives, agents, attorneys, parent or subsidiary companies, affiliates, officers, directors, and/or employees thereof, assumes any personal liability as a result of this Settlement.

1.4. The Signatories agree that the Commission has primary jurisdiction over any interpretation, enforcement, or remedy pertaining to this Settlement, as provided by the California Constitution, Article XII, Section 8. No Signatory may bring an action pertaining to this Settlement in any local, State, or Federal court, or administrative agency, without having first exhausted its administrative remedies at the Commission.

1.5. If any Signatory fails to perform its respective obligations under this Settlement, the other Signatory may come before the Commission to pursue a remedy including enforcement.

1.6. The provisions of this Settlement are not severable. If the Commission or any court of competent jurisdiction overrules, modifies, or conditions any material provision of this Settlement, this Settlement shall be considered rescinded in its entirety pursuant to the provisions of Section 10 of this Settlement.

1.7. The Signatories acknowledge and stipulate that they are agreeing to this Settlement freely, voluntarily, and without any fraud, duress, or undue influence by any other Signatory. Each Signatory hereby states that it has read and fully understands its rights, privileges, and duties under this Settlement, including each Signatory's right to discuss this Settlement with its legal counsel, and has exercised those rights, privileges, and duties to the extent deemed necessary.

1.8. In executing this Settlement, each Signatory declares that the terms and conditions herein are reasonable, consistent with the law, and in the public interest.

1.9. The Signatories acknowledge and agree that this Settlement has been jointly negotiated and drafted. The language of this Settlement shall be construed as a whole according to its fair meaning and not in favor of any Signatory.

1.10. This Settlement constitutes the entire agreement and understanding between the Signatories as to the subject of this Settlement, and supersedes any

prior agreements, commitments, representations, or discussions between the Signatories.

1.11. This Settlement may not be amended or modified without the express written and signed consent of each Signatory hereto.

1.12. No Signatory has relied or relies upon any statement, promise, or representation by any other Signatory, except as specifically set forth in this Settlement. Each Signatory expressly assumes the risk of any mistake of law or fact made by such Signatory or its authorized representative.

1.13. This Settlement and each covenant and condition set forth herein shall be binding upon the respective Signatories hereto.

1.14. Any notice, demand, or other written instrument required or permitted to be given pursuant to this Settlement shall be in writing signed by the Signatory giving such notice and shall be sent to the other Signatory at the following addresses. Notices may be given either by personal delivery, overnight courier, registered or certified mail, or facsimile if followed by a copy sent by personal delivery, courier, or regular mail. Each Signatory may change its address from time to time by written notice to the other Signatory in accordance with this Section.

To GSWC:

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and

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To DWA:

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and

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and

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Facsimile: (415) 703-2262
Email: jjz@cpuc.ca.gov

1.15. This Settlement may be executed in counterparts by each Signatory hereto with the same effect as if all Signatories had signed one and the same document. Any such counterpart shall be deemed to be an original and shall together constitute one and the same Settlement.

1.16. Subject to Section 10, this Settlement shall become effective and binding on the Signatories as of the date it is fully executed by both of the Signatories; provided that Sections 6, 7, and 9, shall only become effective upon approval by the Commission, which approval has become final and no longer subject to appeal ("CPUC Approval").

2. FACTUAL BACKGROUND

2.1. GSWC is a Class A water company regulated by the Commission. GSWC divides its service territory into three geographical regions: Region 1, Region 2, and Region 3. Region 1 incorporates customer service areas in Northern California and California's Central Coast, including the Arden-Cordova Customer Service Area. Regions 2 and 3 encompass areas of Southern California. GSWC's headquarters are located in San Dimas, in Southern California.

2.2. In early 2003, GSWC's senior management became aware of allegations of violations of the company's internal procurement policies in Region 1. Specifically, two officers from Region 1 were alleged to have awarded construction contracts to Richardson Engineering Company ("REC") in violation of GSWC's written procurement policy's requirement for competitive bidding. Nearly all of the contracts awarded to REC were for work in Region 1.

2.3. Commencing in May 2003, GSWC conducted an investigation ("REC Investigation") into possible violations of its procurement policy's requirement for competitive bidding involving the REC contracts primarily in Region 1. As part of its investigation, GSWC retained an outside attorney to conduct an investigation, an outside accountant to review the dollar amounts paid to REC, and an outside engineering firm to prepare construction estimates on a sample of REC's projects to determine whether GSWC had paid more than fair market value for those projects. Each consultant provided GSWC with a written report of findings.

2.4. In October 2003, based upon an initial report by the outside attorney of his findings, GSWC terminated the employment of the two officers that it deemed most responsible for violating GSWC's procurement policy's requirement for competitive bidding when awarding contracts to REC, primarily in Region 1.

2.5. In November 2003, GSWC's outside attorney provided GSWC with his final report wherein he concluded, among other things, that since the early

1990s GSWC had awarded REC approximately 100 contracts for various projects and had paid REC in excess of $20 million. He also concluded that many of these contracts had been awarded to REC in violation of GSWC's procurement policy's competitive bidding requirement and lacked appropriate documentation.

2.6. In October 2004, GSWC's outside engineering firm completed its review of a sample of twenty-two (22) out of the approximately 100 REC projects selected by GSWC, which sample represented more than 50% of the payments made to REC. The engineering firm concluded, among other things, that six of the twenty-two (22) projects sampled exceeded its estimate of fair market value. The engineering firm qualified its opinion stating that, with respect to some projects, it did not know what circumstances REC encountered that could have increased the costs beyond its estimate of fair market value.

2.7. After receiving the outside engineering firm's report in October 2004, GSWC evaluated whether it was obligated to report the results of its REC Investigation to the Commission. After analysis, including consultation with its former outside regulatory counsel, GSWC determined that it had no such obligation and, thereafter, concluded its REC Investigation.

2.8. In February 2007, a then senior officer of GSWC met with the Commission's then General Counsel and informed him about GSWC's REC Investigation. The senior officer indicated that GSWC had not disclosed the findings from its REC Investigation to the Commission when GSWC filed its General Rate Case ("GRC") for Region 1 in January 2007.

2.9. On February 15, 2007, the Commission's Legal Division ("Legal Division") served GSWC with a subpoena for any and all documents related to GSWC's REC Investigation. In June 2007, DWA commenced a limited procurement examination of REC contracts in Region 1. Together, Legal Division and DWA staff ("Commission Staff") commenced a pre-formal investigation into the following:

A. Whether GSWC had violated its procurement policy's competitive bidding requirement when awarding contracts to REC, primarily in Region 1, prior to 2004;

B. Whether improper costs associated with the REC contracts had been included in rates, resulting in harm to ratepayers; and

C. Whether GSWC had violated any Commission rule, regulation, order, or other requirement, or any state law, by failing to disclose the findings from its REC Investigation to the Commission at any time prior to the February 2007 subpoena.

2.10. From 2007 through 2010, Commission Staff engaged in extensive discovery, including issuing numerous data requests, which resulted in the production of more than 20,000 documents, took several examinations under oath of GSWC's senior officers, including GSWC's former President and Chief Executive Officer, its current Senior Vice President of Regulated Utilities, and its current Vice President of Regulatory Affairs, and conducted the aforementioned limited procurement examination of REC contracts from 1989 through 2003 primarily in Region 1.

2.11. As part of its limited procurement examination, Commission Staff requested any and all contracts between GSWC and REC, and related documentation. GSWC provided to Commission Staff contracts and documentation dating from 1972 through 2003. An initial review by Commission Staff of documentation related to REC contracts prior to 1989 provided by GSWC revealed that most of the work performed by, and sums paid to, REC occurred after 1989. Accordingly, Commission Staff focused its limited procurement examination on REC contracts from 1989-2003.

2.12. Commission Staff acknowledges that GSWC cooperated with the Commission Staff's pre-formal investigation at all times.

3. COMMISSION STAFF'S INVESTIGATIVE FINDINGS AND RECOMMENDATIONS

3.1. Commission Staff found evidence that from 1989 through 2003, GSWC awarded approximately 100 construction contracts to REC, primarily in Region 1. Commission Staff found that a number of the REC contracts were for engineering in addition to construction. Commission Staff found many violations of GSWC's procurement policy, including a lack of competitive bidding and a lack of appropriate documentation. Commission Staff also found evidence that GSWC had paid REC in excess of fair market value for several of the REC contracts.

3.2. Commission Staff found evidence that, during and after GSWC's REC Investigation, GSWC continued to file applications that included what Commission Staff found to be excess costs associated with the REC contracts in ratebase (A.03-10-057, A.04-08-042, A.05-02-004, A.07-01-009, and, most recently, A.10-01-009).

3.3. Commission Staff found evidence that for the last twenty-one (21) years (1989-2010), GSWC included a total of $23.7 million of REC costs, including related overhead and direct labor, in calculations affecting rates. The $23.7 million is comprised of $16.4 million of REC contracts, related overhead, and direct labor that went into ratebase, and $7.3 million of the same related to the Arden-Cordova Memorandum Account.

3.4. Commission Staff determined that GSWC's inclusion of the $23.7 million of REC costs in the calculation of its rates from 1989 through 2010 has exposed GSWC's customers to unjust and unreasonable charges and up to $31 million of ratepayer harm.

3.5. Commission Staff recommends that past ratepayer harm be remedied through a surcredit to ratepayers as specified in Section 6 below.

3.6. Commission Staff determined that an adjustment to existing ratebase of up to $8 million, and an adjustment to the Arden-Cordova Memorandum

Account of up to $700,000, would be necessary to prevent future ratepayer harm from these same REC costs.

3.7. Commission Staff recommends that future harm be prevented through an adjustment to existing ratebase and to GSWC's Arden-Cordova Memorandum Account as specified in Section 6 below.

3.8. Commission Staff found that GSWC had a duty to disclose the results of its REC Investigation to the Commission, that GSWC failed to fulfill this duty at any time, and that the consequence of this failure was that GSWC's customers were exposed to unjust and unreasonable rates.

3.9. Commission Staff recommends that a penalty be imposed upon GSWC pursuant to Public Utilities Code Sections 2107-2114, as specified in Section 6 below.

4. GSWC's RESPONSE TO COMMISSION STAFF'S INVESTIGATIVE FINDINGS

4.1. GSWC disagreed with Commission Staff's findings and conclusions, both with respect to ratemaking and more generally, and believed that the weight of the evidence supported GSWC's views.

4.2. GSWC disputed Commission Staff's findings and calculations regarding harm to ratepayers. Among other things, GSWC disputed Commission Staff's finding that violations of its internal procurement policy necessarily resulted in ratepayer harm.

4.3 GSWC concluded that REC completed many construction projects in a competent manner and at a reasonable cost, and, in certain cases, in response to what GSWC found to have been exigent circumstances. Many of the projects completed by REC remain in service today.

4.4 GSWC disputed Commission Staff's findings regarding excess costs associated with REC contracts in customer rates.

4.5. GSWC disputed that it had a duty to disclose the findings of its REC Investigation to the Commission.

5. DISCUSSIONS BETWEEN GSWC AND DWA STAFF REGARDING SETTLEMENT

5.1. In an attempt to resolve their differences, the Signatories held several settlement conferences beginning in June 2010 and continued to have settlement discussions for several months. On November 16-17, 2010, the Signatories participated in a two-day mediation session under the Commission's alternative dispute resolution program. The Signatories reached a Settlement in principle at this mediation.

5.2. For the sole purpose of the Commission's consideration of this Settlement, GSWC agrees not to dispute that GSWC had a duty to disclose the results of its REC Investigation to the Commission, that GSWC failed to fulfill this duty, and that the consequence of this failure was that ratepayers were exposed to unjust and unreasonable costs in their water rates. If the Commission does not approve this Settlement in its entirety and without modification, however, GSWC reserves all rights to contest the foregoing, the findings set forth in Section 3 above, as well as any other findings of Commission Staff.

6. TERMS AND CONDITIONS – REMEDIES

6.1. Customer Credit.

A. Within thirty (30) days after CPUC Approval, GSWC shall file a Tier 1 Advice Letter to initiate refunds to its customers totaling $9.5 million attributable to previously collected revenues associated with REC payments. The refunds shall be apportioned across GSWC's nine ratemaking areas in the following manner: Arden-Cordova, $3,578,522 (36-month amortization); Bay Point, $1,556,435 (36-month amortization); Clearlake, $1,437,211 (36-month amortization); Los Osos, $33,983 (12-month amortization); Ojai, $986,463 (36-month amortization); Santa Maria, $192,566 (12-month amortization); Simi Valley, $993,167 (24-month amortization); Region 2, $322,325 (12-month amortization); and Region 3, $399,328 (12-month amortization).

B. The refunds will be provided through surcredits on monthly bills over a

period of one to three years as specified above in sub-section A of this section (6.1). GSWC shall establish a balancing account for each of the districts for refunding the amounts shown above. The balance in these balancing accounts shall earn interest at the 90-Day Commercial Paper Rate. GSWC shall track the money refunded through the surcredits provided above in the balancing accounts and report to the Director of DWA on the balances and propose a methodology for addressing any balance remaining at the end of the period for amortizing each account.

6.2. Ratebase Adjustment.

Within thirty (30) days after CPUC Approval, GSWC shall file a Tier 2 rate base offset advice letter to reduce rates associated with a reduction in its recorded ratebase by $2.5 million. The ratebase reduction of $2.5 million will be apportioned across GSWC's existing ratemaking areas in the following manner: Arden-Cordova, $1,241,460; Bay Point, $299,587; Clearlake, $266,684; Los Osos, $17,841; Ojai, $250,651; Santa Maria, $98,265; Simi Valley, $267,457; Region 3, $58,055.

6.3. Arden-Cordova Memorandum Account Adjustment.

Within thirty (30) days after CPUC Approval, GSWC shall file a Tier 1 Advice Letter reflecting the reduction of the balance of the existing Arden-Cordova Memorandum Account by $500,000 and shall reduce the surcharge in a proportionate amount.

6.4. Penalty.

Within thirty (30) days after CPUC Approval, GSWC will pay a $1 million penalty to the General Fund of the State of California. This payment shall be made by check or money order, made payable to the "California Public Utilities Commission" and shall note in the lower left hand of the check or money order "For State General Fund Account" and the Commission's Decision ordering the penalty. The check or money order shall be sent to the following address:

Elsa Cerezo
California Public Utilities Commission
Fiscal Office
505 Van Ness Avenue, Room 3000
San Francisco, CA 94102

GSWC shall provide a photocopy of the payment and transmittal letter to Commission Staff at the following address:

Jason J. Zeller, Assistant General Counsel
Maria L. Bondonno, Senior Staff Counsel
California Public Utilities Commission
505 Van Ness Avenue, Suite 4300
San Francisco, CA 94102

6.5. Legal and Investigation Expenses.

A. GSWC agrees not to include any and all legal, investigation, or other expenses incurred in connection with its REC Investigation and with Commission Staff's pre-formal investigation in its historical expense figures for the purpose of determining its expenses for any future rates.

B. GSWC agrees to identify separately any and all litigation costs, investigation costs, and other expenses incurred in connection with any civil litigation arising out of or related to the REC Investigation prior to the date of this Settlement that are included in its historical expenses for the purpose of determining its expenses in any future filings, including, but not limited to, GRCs, including General Office, and Advice Letters. GSWC will identify any and all such costs and/or expenses in a separate paragraph with a reference to the Commission's Decision approving this Settlement.

7. TERMS AND CONDITIONS – FUTURE AUDITS

7.1. GSWC agrees to be subject to three separate independent audits, as specified below, over a period of ten (10) years from the date this Settlement is approved by the Commission, and to cooperate fully with each independent

auditor.

7.2. The three separate independent audits will be limited to an examination, for the time periods specified below, of GSWC's compliance with Commission and GSWC policies and procedures for the procurement of outside contracts for engineering or construction for capital projects in its Region 1, Region 2, Region 3, and General Office, identification of any contracts entered into in violation of such policies, if any, and quantification of the costs associated with any such contracts that were included in rates. The three separate independent audits shall exclude any and all REC contracts that were executed prior to January 1, 2004, except for REC contracts that GSWC intentionally failed to disclose to Commission Staff during its pre-formal investigation, if any.

7.3. For each separate independent audit, DWA will contract for services of an independent auditor pursuant to the requirements set forth in California's State Contracting Manual and California's Public Contract Code, as well as any other applicable statute, rule, or regulation.

7.4. To the extent permitted by California's State Contracting Manual and California's Public Contract Code, DWA agrees to consult with GSWC, in advance of issuing its Request For Proposal ("RFP") for each auditor, regarding appropriate selection criteria and scope of work to be included in the RFP.

7.5. For each separate independent audit, GSWC agrees to pay all costs of the independent auditor pursuant to, and in accordance with, the contracts for services in performing the audit. GSWC agrees not to seek recovery of this expense from its customers at any time. If GSWC reasonably believes that the auditor is exceeding the scope of the audit as provided in Section 7.2 or incurring excessive costs, it shall inform DWA, which will consider if appropriate action needs to be taken. If DWA determines that no action needs to be taken, any dispute regarding the foregoing shall be resolved by the Director of the DWA.

7.6. The Commission's Fiscal Office will bill GSWC for the costs of the independent audits by mailing GSWC an invoice accompanied by a letter setting

forth the due date of payment.

7.7. GSWC will provide any independent auditor, during the course of each audit conducted under this Settlement, with any and all documents requested within the scope of the audit specified in Sections 7.2, subject to attorney-client and attorney-work-product privileges, including copies of GSWC's procurement policies – past, present, and future.

7.8. The findings of the first audit shall be set forth in a "First Audit Report" to be completed within a reasonable period from CPUC Approval. The first audit shall examine GSWC's compliance, for the time period 1994 through the year/s of the audit, with its then current policies and procedures for the procurement of contracts for any outside service of construction or engineering of capital projects in its Region 1, Region 2, Region 3, and General Office (excluding any and all REC contracts that were executed prior to January 1, 2004, except for REC contracts that GSWC intentionally failed to disclose to Commission Staff during its pre-formal investigation, if any), identify any and all contracts entered into in violation of such policies, if any, and quantify the costs associated with any and all such contracts that were included in rates.

7.9. Upon receiving a substantially complete draft of the First Audit Report, DWA will provide GSWC with a copy for comment. GSWC will be allowed forty-five (45) days to review the draft of the First Audit Report and to provide comments to the independent auditor. The independent auditor will incorporate GSWC's comments in the final First Audit Report consistent with standard auditing practices. A copy of the First Audit Report shall be delivered to GSWC, the Director of the DWA, the Director of DRA, the Commission's General Counsel, and to the Supervisor of Legal Division's Water Section, within one week of the date of completion. The First Audit Report shall be deemed confidential pursuant to Section 583 of the Public Utilities Code, as specified in Section 8.

7.10. Within approximately three years following the completion of the First Audit Report, an independent auditor shall conduct a second audit of GSWC's compliance, for the time period from the issuance of the First Audit Report through the second audit, with its then current policies and procedures for the procurement of contracts for any outside service of construction or engineering of capital projects in its Region 1, Region 2, Region 3, and General Office, identify any and all contracts entered into in violation of such policies, if any, and quantify the costs associated with any and all such contracts that were included in rates.

7.11. Upon receiving a substantially complete draft of the Second Audit Report, DWA will provide GSWC with a copy for comment. GSWC will be allowed forty-five (45) days to review the draft of the Second Audit Report and to provide comments to the independent auditor. The independent auditor will incorporate GSWC's comments in the final Second Audit Report consistent with standard auditing practices. A copy of the Second Audit Report shall be delivered to GSWC, the Director of the DWA, the Director of DRA, the Commission's General Counsel, and to the Supervisor of Legal Division's Water Section, within one week of the date of completion. The Second Audit Report shall be deemed confidential pursuant to Section 583 of the Public Utilities Code, as specified in Section 8.

7.12. Within approximately three years following the completion of the Second Audit Report, an independent auditor shall conduct a third audit of GSWC's compliance, for the time period following the issuance of the Second Audit Report through the third audit, with its then current policies and procedures for the procurement of contracts for any outside service of construction or engineering of capital projects in its Region 1, Region 2, Region 3, and General Office, identify any and all contracts entered into in violation of such policies, if any, and quantify the costs associated with any and all such contracts that were included in rates.

7.13. Upon receiving a substantially complete draft of the Third Audit Report, DWA will provide GSWC with a copy for comment. GSWC will be allowed forty-five (45) days to review the draft of the Third Audit Report and to provide comments to the independent auditor. The independent auditor will incorporate GSWC's comments in the final Third Audit Report consistent with standard auditing practices. A copy of the Third Audit Report shall be delivered to GSWC, the Director of the DWA, the Director of DRA, the Commission's General Counsel, and to the Supervisor of Legal Division's Water Section, within one week of the date of completion. The Third Audit Report shall be deemed confidential pursuant to Section 583 of the Public Utilities Code, as specified in Section 8.

7.14. Within thirty (30) days of issuance of the First, Second, or Third Audit Report described above, the Signatories agree to discuss whether GSWC needs to take any action. If the Signatories fail to agree about what action needs to be taken by GSWC, within thirty (30) days of their first meeting, each Signatory shall be free to pursue whatever action it deems necessary.

8. TERMS AND CONDITIONS – CONFIDENTIALITY

8.1. The Signatories agree to maintain the confidentiality of all negotiations and communications made during the course of discussions in this matter and agree that such communications remain subject to Rule 12.6 of the Commission's Rules of Practice and Procedure.

8.2. The Signatories agree that any document submitted by GSWC to Commission Staff during the course of its pre-formal investigation remain protected from disclosure by Section 583 of the California Public Utilities Code.

8.3. The Signatories agree that any documents provided by GSWC to the independent auditors shall be deemed confidential pursuant to Section 583 of the California Public Utilities Code.

8.4. The Signatories agree that any and all audit reports and/or any other documents produced by the independent auditors to the Commission regarding the audits described in Section 7 of this Settlement shall be deemed confidential pursuant to Section 583 of the California Public Utilities Code.

9. TERMS AND CONDITIONS – RESOLUTION AND RELEASE

9.1. The Signatories agree that this Settlement resolves all disputes and disagreements between the Signatories as to facts and law and, upon CPUC Approval, the Commission generally releases GSWC from any claim, known or unknown, foreseen or unforeseen, that arose or may have arisen as a result of Commission Staff's pre-formal investigation into GSWC's procurement practices as they relate to any and all REC contracts that were executed prior to January 1, 2004, and GSWC's dealings with REC and related matters, including without limitation: any and all claims and matters related to GSWC's internal investigation into the REC contract matters; GSWC's duty, if any, to disclose to the Commission any information related to its procurement practices as they relate to REC; and GSWC's actions and conduct in connection with Commission Staff's pre-formal investigation (collectively, "Released Claims").

9.2. The Released Claims do not include any claims related to (1) REC contracts GSWC intentionally failed to disclose to Commission Staff during its pre-formal investigation; (2) REC contracts entered into by GSWC in Region 1, Region 2, Region 3, and/or General Office after December 31, 2003, if any; or (3) any contract that is the subject of the audits described in Section 7 above.

9.3 For purposes of this Section 9, references to GSWC includes GSWC and its legal successors, predecessors, assigns, partners, joint ventures, shareholders, members, representatives, agents, attorneys, parent or subsidiary companies, affiliates, former and current officers, directors, and/or employees.

9.4 The Commission, and its employees and contractors, will neither initiate nor continue any enforcement action nor seek any further administrative or other penalties against GSWC based on the Released Claims.

10. TERMS AND CONDITIONS - APPROVAL BY THE COMMISSION

10.1. The Signatories agree that within one day of their execution of this Settlement they will jointly file this Settlement for Commission approval by motion under Commission Rule 12.1(a). In their joint motion, the Signatories will ask that the Commission expeditiously consider and approve this Settlement, without condition or modification, and in any case issue a decision within ninety (90) days of the date of the joint motion. The joint motion will also ask that the Commission consider this Settlement without holding a pre-hearing conference or permitting discovery, testimony, or hearings.

10.2. If the Commission permits discovery, testimony, or hearings on this Settlement, GSWC will have the right, but not the obligation, to terminate this Settlement upon written notice to DWA. Upon any such notice, this Settlement shall be rescinded, the Signatories shall be released from any obligation, representation, or condition set forth in this Settlement, including their obligation to support this Settlement, and the Signatories shall be restored to their positions prior to having entered into this Settlement. Thereafter, the Signatories may pursue any action they deem appropriate.

10.3. The Signatories agree to support this Settlement and use their best efforts to secure the Commission's approval of this Settlement in its entirety and without condition or modification.

10.4. Without limiting GSWC's rights in Section 10.2, the Signatories agree that, if the Commission fails to adopt this Settlement in its entirety, or if the Commission adopts this Settlement with conditions or modification, the Signatories shall convene a conference within fifteen (15) days thereof to discuss whether they can resolve any issue raised by the Commission's actions. If the Signatories cannot agree to resolve any issue raised by the Commission's actions within thirty (30) days of their conference, this Settlement shall be rescinded, the Signatories shall be released from any obligation, representation, or condition set

forth in this Settlement, including their obligation to support this Settlement, and the Signatories shall be restored to their positions prior to having entered into this Settlement. Thereafter, the Signatories may pursue any action they deem appropriate.

10.5. The Signatories agree to defend this Settlement before the Commission if the Commission's adoption of this Settlement is opposed by any one else.

11. GOVERNING LAW

11.1. This Settlement shall be governed by the laws of the State of California as to all matters, including validity, construction, effect, performance, and remedy.

12. CONCLUSION

12.1. The Signatories mutually believe that, based on the terms and conditions set forth above, this Settlement is reasonable, consistent with the law, and in the public interest.

12.2. Each signatory to this Settlement represents that his or her signature to this Settlement binds his or her respective Signatory to the terms of this Settlement.

DATED: _____ _____

Robert Sprowls
President and Chief Executive Officer
Golden State Water Company

DATED: June 27, 2011 _____

Kayode Kajopaiye
Division of Water and Audits
California Public Utilities Commission

12.2. Each signatory to this Settlement represents that his or her signature to this Settlement binds his or her respective Signatory to the terms of this Settlement.

DATED: June 27, 2011 Robert J. Sprowls

Robert Sprowls
President and Chief Executive Officer
Golden State Water Company

DATED: _____ _____

Kayode Kajopaiye
Division of Water and Audits
California Public Utilities Commission