WATER/FLC/SNR/LEP:jrb

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

WATER DIVISION **RESOLUTION NO. W-4462**
April 22, 2004

R E S O L U T I O N

(RES. W-4462), CALIFORNIA WATER SERVICE COMPANY (CWSC), SALINAS AND BAKERSFIELD DISTRICTS. ORDER AUTHORIZING THE ACQUISITION OF THREE WATER COMPANIES AND RATES FOR TWO OF THEM, AUTHORIZING SURCHARGES IN THE SALINAS DISTRICT TO RECOVER UNDERCOLLECTIONS IN PURCHASED POWER BALANCING ACCOUNT PRODUCING ADDITIONAL ANNUAL REVENUES OF $394,707 OR 5.1% FOR THE SALINAS DISTRICT, AND GRANTING WITHDRAWAL OF ADVICE LETTER 1542.

SUMMARY

By Addendum filed on February 5, 2004, which amended Advice Letters 1514 and 1515 filed on May 7, 2002, CWSC seeks authority: (1) to acquire Country Meadows Mutual Water Company (CMMWC) and Indian Springs Mutual Water Company (ISMWC); (2) to include ISMWC's system in CWSC's Salinas District; (3) to charge ISMWC customers a flat rate of $37.12, the same as the average cost of service to serve the Salinas District customers, (4) to continue to charge CMMWC customers the current flat rate of $49 per customer per month, which charge is reasonable based on the CWSC's currently authorized rate of return, and (5) to incorporate CMMWC to Salinas District's rate schedule after the installation of meters for all customers are completed.

By Addendum filed on February 5, 2004, which amended Advice Letter 1517 filed June 26, 2002, CWSC seeks authority to acquire Olcese Water District and merge it with CWSC's Bakersfield District.

By Addendum filed on February 5, 2004, which amended Advice Letter 1532 filed on January 2, 2003 for its Salinas District, CWSC seeks authority to amortize

an undercollection in the amount of $394,707 in the purchase power balancing account as of November 29, 2001 pursuant to Decision (D.) 02-12-055.

By Addendum filed on February 5, 2004, which amended Advice Letter 1542, filed on March 17, 2003 for its Bakersfield District, CWSC proposes to withdraw Advice Letter 1542 because the adjusted balance in the balancing account is less than 2% of the annual Bakersfield District revenues.

This resolution grants the authority sought in Advice Letters 1514, 1515 and 1532; allows CWSC to withdraw Advice Letter 1542; and refers that the noncompliance issue raised in Advice Letter 1517 be dealt similarly as would be decided in CWSC's pending GRC decision on Application (A.) 01-09-062 for the Salinas District.

BACKGROUND

As described in Resolution W-4390, adopted by the Commission on July 10, 2003, during its investigation of CWSC's consolidated General Rate Case (GRC) A. 01-09-062, the Office of Ratepayer Advocates (ORA) discovered that CWSC was providing unapproved public utility water service to two areas formerly served as Indian Springs Mutual Water Company and Country Meadows Mutual Water Company (Indian Springs and Country Meadows) in its Salinas District. Although CWSC had been providing this water service for five years to Indian Springs customers and two years to Country Meadows customers, the utility had never filed an advice letter seeking Commission approval to expand its service territory as required by General Order 96-A, D.97-03-028 and Section 702 of the Public Utilities Code.[1] Also CWSC had been charging customers for the water service, without rate approval from the Commission as required by Sections 451 and 454 of the Code.

The ALJ and the assigned Commissioner both questioned why CWSC had not filed advice letters requesting that the acquisitions be included in the utility's service territory. Therefore, on May 7, 2002, CWSC filed Advice Letters 1514 and 1515 requesting Commission approval of the utility's acquisition of Country Meadows, a 98-customer water system and Indian Springs, a 175-customer water

[1] Unless otherwise indicated, all code references are to the Public Utilities Code.

system. The advice letters requested that both acquisitions be added to the utility's Salinas District and that the flat rates agreed to in the respective sales contracts be maintained. ORA protested the advice letters.

In the GRC, ORA filed a motion requesting that the Commission issue an order to show cause or open an investigation into CWSC's improper service in the Salinas District. In its response, CWSC did not dispute that it acquired and served the Indian Springs and Country Meadows water systems without the requisite Commission authorization to serve the areas and charge rates. The Commission issued an interim order, D.03-01-081 requiring the GRC parties to address why CWSC should not be required to refund all charges collected in violation of the Code and why fines and other penalties should not be imposed on CWSC for violations of the Code, Commission rules and decisions (Show Cause Order). Commission resolution of this Show Cause Order is pending.

On June 26, 2002, nearly three years after executing a contract of sale (August 10, 1999) for Olcese Water District, a 2,000-customer water system that had been served as an unapproved part of the utility's Bakersfield District, CWSC filed Advice Letter 1517 requesting Commission approval of the utility's acquisition.

ORA's late-filed protest to this advice letter noted CWSC's violation of D. 97-03-028 and argued that CWSC's actions with Olcese was similar to those that resulted in Commission D. 03-01-081. Noting that CWSC's failure to obtain Commission authorization for the Olcese transaction is not a part of that Show Cause Order, ORA recommended that the Commission reject Advice Letter 1517 and open an Order Instituting Investigation or Rulemaking to address the severity of issues involved in processing the unauthorized acquisition of Olcese.

By Advice Letters 1532 and 1542 filed January 2, 2003 for its Salinas District and March 17, 2003 for it Bakersfield District, CWSC sought amortization of the undercollection in the Districts' balancing accounts as of November 29, 2001 as authorized by D.02-12-055. The utility treated Indian Springs and Country Meadows as part of the Salinas District and treated Olcese as part of its Bakersfield District. Since CWSC had no rate approval or territory authorization for Indian Springs, Country Meadows or Olcese on or before November 29, 2001, staff concluded that the inclusion of charges related to those acquisitions in the Districts' balancing accounts would be improper. Therefore staff recommended that Advice Letters 1532 and 1542 be suspended pending Commission

consideration of the removal from the balancing accounts all costs, if any, associated with the acquired water companies.

ISSUES

Resolution W-4390 addressed Advice Letters 1514, 1515, 1517, 1532 and 1542, defined issues, and allowed CWSC along with CMMWC and ISMWC to consult with the Water Division to resolve the issues. The issues raised in Resolution W-4390 are as follows:

Advice Letter Nos. 1514 and 1515

The contract transferring CMMWC and ISMWC contained provisions, which appeared to have been contrary to law and needed to be resolved before the Advice Letters 1514 and 1515 could be considered. Examples include:

> "3.2 Water Rates to be Charged to Indian Springs Customers by Buyer. Buyer agrees that during the first five year period after closing, Buyer will bill each Indian Springs residential customers a monthly flat rate charge of $22.17 for potable water service provided. At the end of the five-year period, Indian Springs residential customers will be billed at the flat rate and/or metered rate, as applicable, in effect at the time for Buyer's Salinas District as authorized by Commission. As required by California law, any new service installations must be metered and will be billed at Buyer's Salinas District metered rates as authorized by Commission and in effect at time such new service commences."

> "11.7 Public Utilities Commission Notification. Buyer warrants, that to the best of its knowledge, execution of this Agreement of Sale is not subject to prior approval of the Commission. Buyer will, subsequent to closing date, provide notification to the Commission advising of the transaction and request the Commission's authorization for the flat rate billing tariff described in subsection 3.2. However, Buyer's failure to obtain such authorization will not affect Buyer's obligation under subsection 3.2."

Except that the sales contract with Country Meadows promised flat rates of $49 per month for five years, the Country Meadows' contract provisions were virtually identical to those quoted above. In addition, the Country Meadows contract included the following promise of questionable legality.

> "10. Capital Improvements. Buyer agrees that Buyer will install during the two (2) years following the Closing Date the capital improvements to the System described in Exhibit F hereto having an aggregate value of approximately $125,000.00 as set forth therein. Such capital improvements shall be included in Buyer's capital improvement plan for Buyer's entire Salinas District."

CWSC, CMMWC, and ISMWC have amended the contracts to conform with the law and filed revised languages, with the addendums, to Advice Letters 1514 and 1515. Amended contract language is attached as Appendix A and B to this resolution.

Advice Letter No. 1517

Water Division staff reviewed the Olcese sales contract. While the plain language of this contract did not appear contrary to the law, it was clear that CWSC failed to keep some of its contractual promises on a timely basis including the legal requirement that the utility obtain Commission approval for rates and service territory expansion. For example these contract provisions include legal requirements that the utility apparently did not fulfill as promised:

> "11.2 Water Rates and Fees. Buyer will charge all customers within the area currently served by Seller the same water rates, service charges, special facility fees and water availability costs as Buyer charges all other landowners, customers and/or developers within Buyer's Bakersfield Tariff Area, as approved by the CPUC." (CWSC/Olcese Sales Contract, page 19.)

"11.7 **CPUC Approval of Acquisition of Water System**

11.7.1 Buyer represents and warrants to Seller that Buyer has a Memorandum of Understanding with CPUC pursuant to which Buyer may annex contiguous service area without the prior approval of CPUC. Seller acknowledges receipt from Buyer of a copy of such Memorandum of Understanding.

11.7.2 Buyer shall obtain any and all other approvals which the CPUC may require for ownership or operation of the Water System." (CWSC/Olcese Sales Contract, page 20.)

It seemed that CWSC was cognizant of the legal requirement that it expeditiously seek Commission authorization of its expanded service territory. The Memorandum of Understanding (MOU) identified in the above-quoted contract provision presumably is the MOU adopted in the Commission's D.97-03-028. Yet, CWSC didn't attempt to comply with the MOU until two years later, when it filed Advice Letter 1517. It also seemed that CWSC did not seek rate approval before serving the Olcese customers when, just days before the proposed final closing date for that sales transaction (October 29, 1999), the Commission issued its decision in the merger/acquisition rulemaking. That decision states that, in all mergers or acquisitions, Commission approval of rates is a legal prerequisite to the imposition of charges for service (See D.99-10-064, dated October 21, 1999.)

Since the Olcese water system was incorporated into the Bakersfield District by D. 01-08-039, the last general rate case for the Bakersfield District, no rate adjustments are needed after the effective date of the decision. However, rates charged between the date of purchase October 29, 1999 and the Bakersfield GRC D. 01-08-039, were obtained without Commission approval. Because this issue is analogous to a matter being reviewed by the Commission in CWSC's Salinas District in A. 01-09-062, this matter will be transferred to that proceeding for disposition. The

Commission decision on that case will dictate the action to be taken regarding the issues raised here.

Advice Letter Nos. 1532 and 1542

The issue raised in these advice letters is whether CWSC's balancing account amortizations requested in Advice Letters 1532 and 1542 improperly included amounts for the Indian Springs, Country Meadows and Olcese Water District acquisitions.

DISCUSSION

Advice Letter Nos. 1514 and 1515

With respect to the acquisition of the Indian Springs system (acquired in March 1997) and the reasonableness of the rates, CWSC requests authorization to incorporate Indian Springs into the Salinas District, install meters within 12 months in response to Water Division's request, and bill customers at the applicable rates under Schedule No. SA-1. Indian Springs is adjacent to the Salinas District's Los Palmas system and a water main has been installed connecting the two systems. Until all meters are installed, CWSC proposes to bill the Indian Springs customers under the metered rates for Schedule No. SA-1 based on the average usage of all Indian Springs customers. The proposed charge for the Indian Springs customers until the installation of meters is completed would be $37.12 per customer per month compared to the current flat rate charge of $22.17. Since the proposed rate is based on the cost of service for the Salinas District, Indian Springs customers will be billed the same rates as the Salinas District customers for the same level of service. This insures that the Indian Springs customers will be billed at rates that are just and reasonable and non-discriminatory. Moreover, installing meters and billing at metered rates will promote water conservation, which is consistent with state policy. Based on the close proximity of the CWSC's Salinas and Indian Springs water systems as shown on the revised service area map in Advice Letter 1515 and the revised rates above it is appropriate to merge Indian Springs into the Salinas District.

For the acquisition of the Country Meadows system (acquired in August 2000) and the reasonableness of the rates, CWSC requests authorization to incorporate Country Meadows into the Salinas District, install meters within 24 months in response to Water Division's request, and bill customers at the current flat rate of $49 per customer per month. Since CWSC proposes first to install meters in the

Indian Springs system (since it was acquired first) and then in the Country Meadows system, additional time is requested to install meters in Country Meadows. Because of the additional time for metering the Country Meadows system CWSC requests that the Country Meadows system not be incorporated into the Salinas District rate Schedule No. SA-1 until the installation of meters for all customers is completed. Until then, CWSC proposes to continue to bill customers at the current flat rate of $49, which it believes is reasonable based on a 9.02% rate of return, the cost of service as shown in the summary of earnings for Country Meadows. Once meters are installed Country Meadows customers will be billed at the Schedule No. SA-1 rates. Installing meters in Country Meadows and billing at metered rates will promote water conservation, which is consistent with state policy. Based on the close proximity of the CWSC's Salinas and Country Meadows water systems as shown on the revised service area map in Advice Letter 1514, and billing at the Salinas District metered rates, it is appropriate to merge Country Meadows into the Salinas District after meters are installed. During discussions with the Director of Water Division additional information was requested concerning the original cost less depreciation of the assets that were purchased from Indian Springs and Country Meadows. Indian Springs assets had a net value of $163,294 compared to the purchase price of $128,000 and Country Meadows had a net value of $108,615 compared to a purchase price of $16,740. Since the purchase price for each system was less than the original cost less depreciation, CWSC booked the purchase price in lieu of the net plant value at the time of sale.

Advice Letter Nos. 1517, 1532 and 1542

CWSC reviewed the entries in the Salinas District balancing account and identified a total of $8,734 through November 29, 2001 and an additional $15,339 from November 29, 2001 through December 31, 2002 (both amounts include interest) in purchased power costs for the Indian Springs and Country Meadows water systems that were included in the account. Accordingly, CWSC has removed $8,734 from the Salinas District balancing account and $15,339 from the Salinas District balancing-type memorandum account and agrees that it will not seek recovery for those costs. No amounts are recorded in CWSC's balancing and balancing type memorandum accounts after December 31, 2002 for Indian Springs and Country Meadows. Only after Indian Springs and County Meadows are incorporated into the Salinas District will amounts be credited to the balancing-type memorandum account. Also, CWSC has reduced the amortization requested in Advice Letter 1532 by $8,734 from $403,441 to $394,707

to reflect the amounts included in the balancing account for Indian Springs and Country Meadows through November 29, 2001.

Additionally, CWSC reviewed the entries in the Bakersfield balancing account and identified a total of $22,600, including interest, in purchased power costs related to the Olcese water system prior to the authorization of rates for Olcese upon its inclusion in the Bakersfield District. This amount has been removed from the Bakersfield District balancing account. As a result of this adjustment the amortization of the Bakersfield District balancing account through November 29, 2001 has been reduced to $218,782. However, since the adjusted amortization amount is less than 2% of the annual Bakersfield District revenues Advice Letter 1542 should not be processed. Water Division has previously rejected all CWSC's balancing account advice letters filed in compliance with D.02-12-055 where the requested amortization was less than 2% of annual revenues, the threshold for balancing account amortizations. Accordingly, CWSC requests that it be authorized to withdraw Advice Letter 1542 and seek recovery in a subsequent reserve account filing.

Rates for the Olcese water system were authorized along with those for the Bakersfield District by D. 01-08-039, the last general rate case for the Bakersfield District. Therefore, no rate adjustments are needed after the effective date of the decision. However, until CWSC filed the instant Advice Letter 1517, it had not requested that the Bakersfield service territory include the Olcese system. That issue is resolved in this resolution. Furthermore, rates charged Olcese customers between the date of purchase October 29, 1999 and the Bakersfield GRC D.01-08-039, were obtained without Commission approval. Because this issue is analogous to a matter being reviewed by the Commission in CWSC's Salinas District in A. 01-09-062, this matter will be transferred to that proceeding for disposition. The Commission decision on that case will dictate the action to be taken regarding the issues raised here.

NOTICE

A notice of the proposed addendum to the Advice Letters 1514, 1515, 1517, 1532 and withdrawal of Advice Letter 1542 was sent to adjacent utilities, both privately and publicly owned, and parties, which have requested notification of tariff filings related to the Salinas and Bakersfield Districts, have been furnished a copy of the advice letters. No protests have been received. All persons or

entities that received notice of the advice letters should be served with this resolution.

FINDINGS

1. Country Meadows and Indian Springs, former mutual water companies, were being served by CWSC's Salinas District.
2. Country Meadows and Indian Springs had not been placed into CWSC's official service territory and the flat rates formerly charged by the mutuals were still being charged.
3. CWSC did not request Commission approval prior to expanding its service territory to include Country Meadows and Indian Springs or to charge rates to the customers of these areas.
4. CWSC had acted without Commission approval when it served as part of its Bakersfield District and charged rates for that service the customers of Olcese Water District, a water system acquired by CWSC pursuant to sales contract executed August 10, 1999 and closing occurred on October 29, 1999.
5. To the extent that provisions of the sales contracts for the acquisition of Country Meadows, Indian Springs, or Olcese state, suggest or imply that service can be extended or rates can be established by the utility without Commission authorization, said provisions are contrary to law.
6. General Order 96-A, D.97-03-028 and Section 702 of the Public Utilities Code require utilities to obtain Commission approval to expand service territory.
7. Sections 451 and 454 of the Public Utilities Code and D. 99-10-064 require utilities to obtain Commission approval to charge rates for water service prior to the commencement of said service.
8. CWSC violated Commission decisions and provisions of the Public Utilities Code when it failed to seek Commission approval to expand its service territories to include the Country Meadows, Indian Springs and Olcese water systems and to charge customers of those acquired water systems for said water service.
9. CWSC knew, or should have known, that it acted in violation of state law when it served water and collected rates not authorized by this Commission.
10. By Resolution W-4390, the Commission directed the Director of the Water Division to establish consultation meetings between staff and the parties to the two acquisition contacts between California Water Service Company and

Indian Springs Mutual Water Company, and California Water Service Company and Country Meadows Mutual Water Company, for the purpose of reforming the acquisition contracts in the public interest and further, to address and resolve issues raised in the resolution regarding the balancing account advice letters for the Bakersfield District and the Salinas District, and proposed just and reasonable rates for ratepayers of the Indian Mutual Water Company and Country Meadows Mutual Water Company.

11. The Director of the Water Division has had consultation meetings with California Water Service Company's representative and discussed reforming the acquisition contracts with the attorneys for Indian Spring Mutual Water Company and Country Meadows Mutual Water Company (the same attorney represents both mutual companies). The modifications of the acquisition agreements have been made and just and reasonable rates have been developed.

12. The purchase contracts for Country Meadows Mutual Water Company and Indian Springs Mutual Water Company were amended to properly reflect this Commission's authority and to conform with law effective March 9, 2004.

13. The proposed flat rate of $37.12 per customer per month for Indian Springs Mutual Water Company is just and reasonable.

14. The proposed continuation of the flat rate of $49.00 per customer per month for Country Meadows Mutual Water Company is just and reasonable.

15. The Salinas District's purchased power balancing account has been adjusted to remove the charges incorrectly included in the amounts of $8,734 for the period through November 29, 2001 and $15,339 for the period from November 29, 2001 through December 31, 2002 (both amounts include interest) for Indian Springs and Country Meadows mutual water companies.

16. Amended Advice Letter 1532 reduced the requested amount of amortization of the Salinas District's balancing account as of November 29, 2001 by $8,734 to $394,707.

17. Advice Letter 1532 requests recovery of balancing account balances as of November 29, 2001 only for Salinas District.

18. The Bakersfield District's purchased power balancing account has been adjusted to remove the charges incorrectly included in the amount of $22,600 for the Olcese water system.

19. The proposed surcharge of $0.0361 per 100 cubic feet of water used to recover an undercollection with the Salinas District purchased power balancing account is reasonable.

20. CWSC's proposal to withdraw Advice Letter 1542 is reasonable.

THEREFORE IT IS ORDERED THAT:

1. As requested in Advice Letter 1517, California Water Service Company is authorized to include Olcese Water System in its authorized service territory for the Bakersfield District.

2. California Water Service Company is authorized to include Indian Springs Mutual Water Company Systems in its Salinas District.

3. California Water Service Company is authorized to include Country Meadows Mutual Water Company as an independent district and to charge the flat rate of $49 per customer per month.

4. California Water Service Company is required to meter water service for its Country Meadow customers during the next two years.

5. California Water Service Company is authorized to file an advice letter upon completion of metering of all customers of the Country Meadows Mutual Water Company to merge the Country Meadows Mutual Water Company system with the Salinas District and make effective the rates and charges of the Salinas District tariffs to Country Meadows Mutual Water Company system.

6. California Water Service Company is authorized to make effective revised rates Schedule Nos. SA-1, General Metered Service; SA-BK-1, General Metered Service; SA-LL-1, General Metered Service; SA-OH-1 General Metered Service; SA-IS-2R, Residential Flat Rate Service, as attached to Advice Letters 1515 and 1532, (addendums), using the original advice letter numbers, and to concurrently cancel the presently effective rate schedules.

7. California Water Service Company's request to reduce balancing account effective November 29, 2001 to remove $22,600 recorded for the Olcese water system and to withdraw Advice Letter 1542 is granted.

8. California Water Service Company's request to reduce the Salinas Districts balancing account by $8,734 for the period through November 29, 2001 and by $15,339 for the period from November 29, 2001 through December 31, 2002 to

correct improper charges on account of operations of Indian Springs and Country Meadows mutual water companies is granted.

9. The balancing account pertaining to Advice Letter 1532 as adjusted shall be processed separately.

10. California Water Service Company is directed to keep maintaining its balancing accounts as required by Public Utilities Code Section 792.5.

11. Charges to Olcese customers, from October 29, 1999 through August 23, 2001, the effective date of Bakersfield District general rate case decision, without the Commission approval, shall be disposed of in the pending Salinas District's general rate case proceeding A.01-09-071.

12. Actions ordered in the Commission's pending decision on California Water Service Company's GRC A.01-09-062 for Salinas District with respect to failing to obtain Commission's approval to charge rates prior to commencement of service will expand to address all the three acquired water systems (Indian Springs Mutual Water Company, Country Meadows Mutual Water Company and Olcese Water District).

13. This resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on April 22, 2004; the following Commissioners voting favorably thereon:

WILLIAM AHERN
Executive Director

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

APPENDIX A

FIRST AMENDMENT TO AGREEMENT OF SALE

This First Amendment to Agreement of Sale (the "Amendment") is made effective as of the Effective Date of the Agreement of Sale (as defined hereinafter) by and between Country Meadows Mutual Water Company, a California corporation ("Seller"), and California Water Service Company, a California public utility water corporation ("Buyer") whose operations are regulated by the California Public Utilities Commission (the "Commission").

WHEREAS, Buyer and Seller entered into that certain Agreement of Sale (the "Agreement") made effective as of March 9, 2000 (the "Effective Date") for the conveyance by Buyer of its water system assets to Seller;

WHEREAS, pursuant to the Agreement Buyer's conveyance of its water system assets to Seller and Seller's acquisition of said assets from Buyer was consummated on August 4, 2000;

WHEREAS, on July 10, 2003 the Commission adopted Resolution No. W-4390 under which, in connection with the Commission's consideration of Seller's Advice Letter 1514 filed May 7, 2002 seeking, *inter alia*, the Commission's approval of its acquisition of the said water system assets and the rates charged to the customers served by said water system, the Commission ordered the Director of the Water Division to establish consultation meetings between staff and representatives of Buyer and Seller for the purpose, *inter alia*, of reforming the Agreement in the public interest;

WHEREAS, such consultations have occurred; and

WHEREAS, in view of Commission Resolution No. W-4390 and such consultations, Buyer and Seller each desires to amend the Agreement as hereinafter set forth;

NOW, THEREFORE, the parties hereby amend the Agreement in the following respects:

1. Section 3.2 of the Agreement is hereby stricken in its entirety and replaced with the following:

> 3.2 <u>Water Rates to be Charged to Country Meadows Customers by Buyer.</u> Buyer agrees that during the first five (5) year period after the Closing, Buyer will bill each existing Country Meadows customer with respect to whom water service has been initiated a monthly flat rate charge of $49.00 for potable water service provided, subject to Commission approval. At the end of the five (5) year period, Country Meadows customers with respect to whom water service has been initiated will be billed, subject to

Commission approval, at the flat rate and/or metered rate, as applicable, in effect at the time for Buyer's Salinas District as authorized by the Commission. In no event shall Buyer bill any Country Meadows customer any amount until such time as water service has been initiated for such a customer, whence Buyer will bill such a customer as provided in the preceding sentence.

2. Section 3.3 of the Agreement is hereby stricken in its entirety and replaced with the following:

3.3 Monterey County Water Meter Ordinance. If and when meter installation for Country Meadows customers is mandated by applicable law or by the Commission, Buyer will install, at that time and at Buyer's expense, meters for said customers, including all necessary backflow protection facilities. Buyer agrees to continue to bill, subject to Commission approval, said customers at the monthly flat rate charge of $49.00 during the first five (5) years after the Closing, as applicable as provided in Section 3.2 hereof, irrespective of any metering requirements and installations. However, after this five (5) year period, Buyer will bill, subject to Commission approval, any and all Country Meadows metered customers at Buyer's Salinas District metered rates as authorized by the Commission.

3. Section 10 of the Agreement is hereby stricken in its entirety and replaced with the following:

10. **Capital Improvements**. Buyer agrees that Buyer will install during the two (2) years following the Closing the capital improvements to the System described in Exhibit F hereto having an aggregate value of approximately $125,000 as set forth therein. Subject to Commission approval, such capital improvements shall be included in Buyer's capital improvement plan for Buyer's entire Salinas District.

4. Section 11.7 of the Agreement is hereby stricken in its entirety and replaced with the following:

11.7 Public Utilities Commission Notification. Buyer warrants that execution of this Agreement is not subject to prior approval of the Commission. Buyer will, subsequent to the Closing, provide notification to the Commission advising of the transaction and request the Commission's authorization for the flat rate billing tariff described in Sections 3.2 and 3.3.

As amended by the foregoing, the Agreement remains in full force and effect.

This Amendment may be executed in one or more counterparts, each of which shall be considered an original instrument and all of which together shall be considered one and the same agreement, and shall become effective when each party has delivered a counterpart containing the signatures of such party to the other party. Delivery of executed signature pages by facsimile transmission shall constitute effective and binding execution and delivery of this Amendment.

Seller: COUNTRY MEADOWS MUTUAL WATER COMPANY,
a California corporation

By: _____
Roy Sammut, President

Date: 2-28-04

Buyer: CALIFORNIA WATER SERVICE COMPANY
a California public utility water corporation

By: _____
Francis S. Ferraro, Vice President

By: _____
Name: _____
Title: _____

Date: 3/9/04

(End of Appendix A)

APPENDIX B

SECOND AMENDMENT TO AGREEMENT OF SALE

This Second Amendment to Agreement of Sale (the "Amendment") is made effective as of the Effective Date of the Agreement of Sale (as defined hereinafter) by and between Indian Springs Mutual Utility Company, a California corporation ("Seller"), and California Water Service Company, a California public utility water corporation ("Buyer") whose operations are regulated by the California Public Utilities Commission (the "Commission").

WHEREAS, Buyer and Seller entered into that certain Agreement of Sale (the "Agreement") made effective as of March 12, 1997 (the "Effective Date") for the conveyance by Buyer of its water system assets to Seller.

WHEREAS, Buyer and Seller then amended the Agreement by entering into that certain First Amendment to Agreement of Sale dated May 13, 1997;

WHEREAS, pursuant to the Agreement as so amended Buyer's conveyance of its water system assets to Seller and Seller's acquisition of said assets from Buyer was consummated on June 25, 1997;

WHEREAS, on July 10, 2003 the Commission adopted Resolution No. W-4390 under which, in connection with the Commission's consideration of Seller's Advice Letter 1515 filed May 7, 2002 seeking, *inter alia*, the Commission's approval of its acquisition of the said water system assets and the rates charged to the customers served by said water system, the Commission ordered the Director of the Water Division to establish consultation meetings between staff and representatives of Buyer and Seller for the purpose, *inter alia*, of reforming the Agreement in the public interest;

WHEREAS, such consultations have occurred; and

WHEREAS, in view of Commission Resolution No. W-4390 and such consultations, Buyer and Seller each desires to further amend the Agreement as hereinafter set forth;

NOW, THEREFORE, the parties hereby further amend the Agreement in the following respects:

1. Section 3.2 of the Agreement is hereby stricken in its entirety and replaced with the following:

> 3.2 <u>Water Rates to be Charged to Indian Springs Customers by Buyer.</u> Buyer agrees that during the first five (5) year period after the Closing, Buyer will bill each Indian Springs residential customer a monthly flat rate charge of $22.17 for potable water service provided, subject to Commission approval. At the end of

the five (5) year period, Indian Springs residential customers will be billed, subject to Commission approval, at a flat rate and /or metered rate, as applicable, in effect at the time for Buyer's Salinas District as authorized by the Commission. As required by California law, any new service installations must be metered and will be billed, subject to Commission approval, at Buyer's Salinas District metered rates as authorized by the Commission and in effect at the time such new service commences.

2. Section 3.3 of the Agreement is hereby stricken in its entirety and replaced with the following:

3.3 Monterey County Water Meter Ordinance. If and when meter installation for Indian Springs residential customers is mandated by Monterey County ordinance or by the Commission, Buyer will install, at that time and at Buyer's expense, meters on existing services for said residential customers, including all necessary backflow protection facilities. Buyer agrees to continue to bill, subject to Commission approval, said residential customers at the monthly flat rate charge of $22.17 during the first five (5) years after the Closing, as provided in Paragraph 3.2 hereto, irrespective of said metering requirements and installations. However, after this five (5) year period, Buyer will bill, subject to Commission approval, any and all Indian Springs metered residential customers at Buyer's Salinas District metered rates as authorized by the Commission.

Buyer will install, within a reasonable time after the Closing and at Buyer's expense, meters on the Indian Springs waste water treatment plant services and the Indian Springs Ranch Property Owners building services, and any other non-residential services within the System, as well as all necessary backflow protection facilities for such services. Buyer will bill, subject to Commission approval, such services at Buyer's Salinas District metered rates as authorized by the Commission.

3. Section 11.7 of the Agreement is hereby stricken in its entirety and replaced with the following:

11.7 Public Utilities Commission Notification. Buyer warrants that, to the best of its knowledge, execution of this Agreement of Sale is not subject to prior approval of the Commission. Buyer will, subsequent to the Closing, provide notification to the Commission advising of the transaction and request the Commission's authorization for the flat rate billing tariff described in subsection 3.2.

As modified by the foregoing, the Agreement remains in full force and effect.

This Amendment may be executed in one or more counterparts, each of which shall be considered an original instrument and all of which together shall be considered one and the same agreement, and shall become effective when each party has delivered a counterpart containing the signatures of such party to the other party. Delivery of executed signature pages by facsimile transmission shall constitute effective and binding execution and delivery of this Amendment.

Seller: INDIAN SPRINGS MUTUAL UTILITY COMPANY
a California corporation

By: _____
Mike Sewell, President

Date: 2/29/04

Buyer: CALIFORNIA WATER SERVICE COMPANY
a California public utility water corporation

By: _____
Francis S. Ferraro, Vice President

By: _____
Name: _____
Title: _____

Date: 3/9/04

(End of Appendix B)