APPENDIX A

SETTLEMENT AGREEMENT

Execution Copy

SETTLEMENT AGREEMENT (A.06-02-026)
February 16, 2007

A. Purpose

The purpose of this Settlement Agreement is to resolve certain issues regarding litigation costs raised in Golden State Water Company's ("GSWC") Application (A.)06-02-026 before the California Public Utilities Commission ("Commission"). The Settlement Agreement does not resolve any other issues in A.06-02-026 and has no bearing on possible Commission approval of the Stipulation entered into by GSWC and other parties in the Superior Court of the State of California, County of Santa Clara, to resolve a state court water rights adjudication affecting GSWC's water rights in the Santa Maria Groundwater Basin.[1]

The terms of this Settlement Agreement are set forth below.

B. Settlement Parties

This Settlement Agreement is entered into by GSWC, Orcutt Area Advisory Group Inc. ("OAAG") and the Division of Ratepayer Advocates ("DRA") ("Parties"), as identified by their signatures herein.

C. Definitions

The following definitions shall apply to the terms of this Settlement Agreement:

1. "Basin" refers to the Santa Maria Groundwater Basin.

2. "Nipomo Pipeline" refers to a pipeline and related infrastructure that may be constructed under the terms of the Stipulation as a possible method of delivering Nipomo Supplemental Water from the City of Santa Maria to the Nipomo Mesa Management Area.

3. "Nipomo Supplemental Water" refers to the obligation of certain parties, including GSWC, to purchase supplemental water for delivery to the Nipomo Mesa Management Area at $1250 per acre foot from the City of Santa Maria pursuant to the Stipulation.

4. "Settlement Agreement" refers to all terms and conditions contained in this contract entered into between GSWC, OAAG and DRA resolving issues set forth in A. 06-02-026.

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[1] *Santa Maria Valley Water Conservation District v. City of Santa Maria, et al*, Lead Case No. CV 770214, Superior Court of the State of California, County of Santa Clara.

5. "Stipulation" refers to the Stipulation, a copy of which was attached to A.06-02-026, that GSWC entered into before the Superior Court of the State of California, County of Santa Clara to resolve a state court water rights adjudication affecting GSWC's water rights in the Santa Maria Groundwater Basin.[2]

D. Background

On February 24, 2006, GSWC filed A.06-02-026 for Commission approval of a settlement Stipulation to resolve a state court water rights adjudication affecting GSWC's water rights in the Basin.[3] Pursuant to the Stipulation, GSWC is required, among other things, to (i) pay a portion of the costs to construct the Nipomo Pipeline connecting the City of Santa Maria to the Nipomo Mesa Management Area; and (ii) purchase 250 acre feet per year of Nipomo Supplemental Water at $1250 per acre foot from the City of Santa Maria upon completion of the Nipomo Pipeline for delivery to the Nipomo Mesa Management Area. GSWC is also seeking to recover its historical and future litigation costs associated with the water rights adjudication and Stipulation, and for its capital and operating and maintenance ("O&M") costs that will be incurred by GSWC when it implements the Stipulation. Finally, the Application requests Commission authority to establish two memorandum accounts to facilitate the requested ratemaking treatment.

DRA and OAAG protested the Application and filed testimony challenging certain aspects of the relief requested therein.

After testimony was filed, Nipomo Community Services District ("NCSD"), another party to the Stipulation bearing responsibility for the Nipomo Pipeline and Nipomo Supplemental Water, has begun to consider alternatives to the Nipomo Pipeline. This has caused uncertainty with respect to GSWC's rights and obligations related to the Nipomo Pipeline and Nipomo Supplemental Water provisions under the Stipulation. Because of the unsettled status of the pipeline, the Parties are only able to settle on the litigation costs associated with A.06-02-026 as set forth below.

E. Terms of Agreement

1. GSWC is authorized to capitalize, as an addition to utility plant, $2,722,520 of the nearly $5.5 million of litigation costs incurred prior to January 1, 2006 in defending its water rights in the Basin, as requested in A.06-02-026.

2. GSWC is authorized to amortize the remaining $2,754,211 of the litigation costs incurred prior to January 1, 2006, plus interest, over a ten-year period. Interest shall be at the agreed upon interest rate of the 10 year treasury note rate plus 1.5%, adjusted monthly to reflect changes to the 10 year treasury note rate. By way of example, based upon the average 10 year treasury note rate of 4.76% for January 2007, the agreed upon interest rate for the month of January 2007, if it were applicable, would be 6.26%.

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[2] *Id.*
[3] *Id.*

3. GSWC's recovery and amortization of costs pursuant to Section E, paragraph 2, above, will begin after Commission approval of this Settlement Agreement and following GSWC's submission of a compliance advice letter to the Commission requesting a surcharge in accordance with Section I below. A memorandum cost recovery balancing account and surcharge applicable to all of GSWC's customers will be established to implement the foregoing. The memorandum cost recovery balancing account will incur interest expense during the amortization/recovery period and the calculation of the surcharge will include the recovery of interest and principal costs over a 10-year amortization period. The amortization and the surcharge shall expire no later than 10 years following the initial implementation date of the surcharge.

4. Interest shall begin to accrue prospectively on the date on which GSWC implements the surcharge specified in Section E, paragraph 3 above. Thus, GSWC may begin to accrue interest on the unrecovered balance of $2,754,211 of litigation costs in a memorandum account during the first billing cycle in which it begins billing customers and recording the revenue recovery from the surcharge.

5. GSWC will amortize all litigation costs associated with the Stipulation incurred after December 31, 2005, in a separate 10-year memorandum account in the same manner as set forth in Section E, paragraph 3 above, subject to a reasonableness review of these litigation costs in a subsequent phase of this proceeding or a new proceeding.

6. GSWC shall account for litigation costs in the following manner:

   i. Litigation costs in the amount of $2,754,211 incurred through December 31, 2005, which are herein authorized for recovery via the surcharge implemented according to Section I below, shall be transferred from GSWC's rate base plant or CWIP account to a new memorandum cost recovery balancing account to track the recovery of these litigation costs through collection of the surcharge.

   ii. All litigation costs that have been incurred after December 31, 2005, that have been recorded in rate base plant or CWIP, shall be transferred from rate base plant or CWIP to a separate new memorandum cost tracking account, subject to a reasonableness review of these litigation costs in a subsequent phase of this proceeding or a new proceeding. Interest shall accrue on the litigation costs cost tracking account at the 90-day commercial paper interest rate until subsequent Commission review of the litigation costs as to their reasonableness in a subsequent phase of this proceeding or a new proceeding, at which time approved costs shall be handled pursuant to Section E, paragraph 5, above.

   iii. All other litigation costs that have been or will be incurred after December 31, 2005, which have not been recorded in rate base plant or CWIP, shall be recorded in the separate new memorandum account set forth in Section E, paragraph 6-ii above and subject to a reasonableness review(s) in a subsequent phase of this proceeding or a new proceeding.

iv. Each surcharge subsequently authorized by the Commission pursuant to this agreement and its associated costs shall be separately tracked in its own cost recovery tracking memorandum account. Each authorized surcharge for the recovery of litigation costs shall be separately stated as a line item on customers' bills.

7. To accomplish amortization and recovery over a ten-year period, the surcharge to which Parties agree to be authorized herein to recover the $2,754,211 of litigation costs incurred through December 31, 2005, shall be updated annually by advice letter filing to reflect the most recent 12-month historical data for unamortized litigation costs, interest rate, and sales volumes. The advice letter is to be filed with the Commission no later than November 1 of each year until the expiration of the surcharge and amortization period with a copy provided to DRA, including work papers showing detailed calculations. The surcharge update shall be accomplished by recalculating the surcharge required to recover the estimated unamortized balance as of December 31 of the current year over the remaining term of the amortization, using the most recent 12-month average 10-year Treasury Bond rate plus 1½ % (one and one-half percent) and the most recent Commission adopted forecasted sales volumes for the following year. Alternatively, at GSWC's election (with an explanation for its decision), the surcharge calculation can be based on actual sales volumes for the most recent 12-month period available. As part of the annual advice letter filing, GSWC shall report the actual water sales volumes for the most recent 12-month period available, the amount of revenues collected pursuant to the surcharge, and resulting changes in the cost recovery balancing account. The new surcharge shall be applied to rates on a volumetric basis. The same annual updating requirement shall apply to each subsequently authorized litigation cost recovery surcharge.

8. GSWC will provide to the Commission, DRA and OAAG a status report on the ongoing deliberations concerning the Nipomo Pipeline and Nipomo Supplemental Water issues no later than 30 days after the Commission approves the Settlement Agreement and no less frequently than quarterly thereafter. GSWC will also inform DRA and OAAG of any major developments relating to the Nipomo Mesa Supplemental Water issue in a timely manner as they occur and no less frequently than quarterly.

9. In the event that A.06-02-026 is suspended pending further developments related to the Nipomo Pipeline and Supplemental Water issues, with the exception of the settlement of the litigation costs specified herein, the Parties agree to reopen discovery and to file revised testimony in this proceeding.

10. Adjustments to GSWC's revenue requirement to comply with and to implement this Settlement Agreement will be allocated to ratepayers on a volumetric rate basis, as opposed to fixed monthly charges. Attached to this Settlement Agreement as Appendix A is a schedule showing the estimated ratemaking effects of the proposed surcharges applicable to the recovery of the amortization of litigation costs.

F. Compromise and Support

The Parties agree that this Settlement Agreement reflects a negotiated compromise, and not an agreement or endorsement of disputed facts and law presented by the Parties in the proceeding. The Parties acknowledge that the Settlement Agreement does not resolve any issues other than the litigation costs in A.06-02-026 and does not affect the Commission's ultimate deliberations on the Stipulation entered into by GSWC and other parties in the Superior Court of the State of California, County of Santa Clara, to resolve a state court water rights adjudication affecting GSWC's water rights in the Santa Maria Groundwater Basin. Notwithstanding the foregoing, the Parties, by signing this Settlement Agreement, acknowledge that they pledge support for Commission approval and subsequent implementation of this Settlement Agreement.

G. Complete Package

This Settlement Agreement embodies the entire understanding and agreement of the Parties with respect to the matters described herein, and except as described herein, supersedes and cancels any and all prior oral or written agreements, principles, negotiations, statements, representations or understandings among the Parties.

H. Commission Approval

The Parties will jointly request Commission approval of this Settlement Agreement. The Parties agree to actively support approval of this Settlement Agreement in the underlying proceeding. The Parties also agree to not support any changes to this Settlement Agreement in any regulatory, legislative or judicial forum. In the event the Commission rejects or modifies this Settlement Agreement, the Parties reserve their rights under Rule 12.4 of the Commission's Rules of Practice and Procedure.

I. Implementation

Within 30 days of a Commission decision approving this Settlement Agreement, GSWC will make a compliance filing to implement the rates and provisions of the settlement.

J. Binding Effect

Upon execution of this Settlement Agreement by the Parties, this Settlement Agreement shall become operative and enforceable as between the Parties. This Settlement Agreement shall remain in effect until such time that the Commission rejects this Settlement Agreement or rescinds, alters, or amends any decision adopting this Settlement Agreement pursuant to its authority under Section 1708 of the Public Utilities Code.

K. Governing Law

This Settlement Agreement will be governed by and construed in accordance with the laws of the State of California, excluding any choice of law rules that may specify the laws of another jurisdiction.

SETTLEMENT AGREEMENT

In witness whereof, intending to be legally bound, the Parties have duly executed this Settlement Agreement on February 16, 2007.

GOLDEN STATE WATER COMPANY

By: _____

Name: Keith Switzer

Title: Vice President, Regulatory Affairs

Date: 2/16/07

DIVISION OF RATEPAYER ADVOCATES

By: _____

Name: _____

Title: _____

Date: _____

ORCUTT AREA ADVISORY GROUP INC.

By: _____

Name: _____

Title: _____

Date: _____

SETTLEMENT AGREEMENT

In witness whereof, intending to be legally bound, the Parties have duly executed this Settlement Agreement on February 16, 2007.

GOLDEN STATE WATER COMPANY

By: _____

Name: _____

Title: _____

Date: _____

DIVISION OF RATEPAYER ADVOCATES

By: Maria D. Bondonno

Name: Maria D. Bondonno

Title: PUC Counsel

Date: 2/16/07

ORCUTT AREA ADVISORY GROUP INC.

By: _____

Name: _____

Title: _____

Date: _____

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In witness whereof, intending to be legally bound, the Parties have duly executed this Settlement Agreement on February 16, 2007.

GOLDEN STATE WATER COMPANY

By: _____

Name: _____

Title: _____

Date: _____

DIVISION OF RATEPAYER ADVOCATES

By: _____

Name: _____

Title: _____

Date: _____

ORCUTT AREA ADVISORY GROUP INC.

By: Donald R. Ward

Name: DONALD R. WARD

Title: CHAIRMAN WATER COMMITTEE

Date: FEB 16, 2007

Golden State Water Company
Santa Maria Groundwater Rights
Illustrative Calculation of GSWC/DRA Proposed Surcharge for
Recovery of Litigation Costs

	2007 Proposed Settlement Litigation Cost Recovery
Litigation Costs to Be Amoritzed through 2005	(2,745,211)
Amortization period (years)	10
Interest Rate	6.26%
Payment to Amortize	***$377,594***

	2007	
Pre-2006 Litigation costs - Amortization, over 10 yrs @ 6.1%		
Total Revenue increase	$	377,594
2007 Commission Adopted Annual Water Sales (ccf)		4,010,892
Cost Recovery Increment, per ccf	$	0.09414
Average Residential Monthly Usage		24.00
Estimated Average Revenue Increase per Monthly Residential Customer Bill	***$***	***2.26***
Current Average Residential Monthly Bill		38.96
Percentage Increase		***5.8%***

Note 1: See http://www.federalreserve.gov/releases/H15/Current/, 10-year Treasury Bond rate for January, 2007, of 4.76%, plus 1.5%

(END OF APPENDIX A)