

DRAFT RETURN WATER PLANNING TERM SHEET

This PLANNING TERM SHEET (the “Term Sheet”) is made as of _____, 2016, by and among CALIFORNIA-AMERICAN WATER COMPANY (“CAW”), the SALINAS VALLEY WATER COALITION (“SVWC”), the MONTEREY COUNTY FARM BUREAU (“MCFB”), the MONTEREY PENINSULA REGIONAL WATER AUTHORITY (“Authority”), LANDWATCH MONTEREY COUNTY, the CASTROVILLE COMMUNITY SERVICES DISTRICT (“CCSD”), and [OTHER PARTIES] (individually, “Party”; collectively, “Parties”).

RECITALS

- A. CAW is seeking permits and approvals for the Monterey Peninsula Water Supply Project (“MPWSP”), including a certificate of public convenience and necessity from the California Public Utilities Commission (“CPUC”);
- B. The MPWSP includes a desalination plant that will provide a potable water supply for CAW’s Monterey Peninsula service area. Rather than using an open-ocean intake that would produce only seawater as source water for the desalination plant, the MPWSP desalination plant will produce its source water from subterranean slant wells drilled adjacent to the ocean, which will draw water from strata underlying the ocean. The location of the wells overlies the western portion of the Salinas River Groundwater Basin (“SRGB”).
- C. CAW characterizes its MPWSP as proposing to develop seawater and brackish groundwater originating from the SRGB to produce source water that would be desalinated to provide a potable water supply for CAW’s Monterey Peninsula service area.
- D. The SVWC, MCFB and Landwatch contend that—rather than proposing to use an open-ocean intake that would produce only seawater—CAW’s MPWSP proposes to use wells developed in the SRGB to produce source water for desalination to provide CAW’s Monterey Peninsula service area with a new source of water supply.
- E. The ratio of seawater to brackish SRGB groundwater in the MPWSP source water is anticipated to change over time, with more seawater and less SRGB groundwater anticipated later in the MPWSP’s life;
- F. CAW contends that source water production by the MPWSP is unlikely to cause significant adverse environmental effects with respect to SRGB groundwater resources and is unlikely to cause injury to prior groundwater rights in the SRGB but submits that the Monterey County Water Resources Agency Act (“Agency Act”) authorizes the Monterey County Water Resources Agency (“Agency”) to obtain an injunction prohibiting the export and use of SRGB groundwater outside of the SRGB and certain areas of Fort Ord;
- G. The SVWC, MCFB and Landwatch submit that the Agency Act directly prohibits the export and use of SRGB groundwater outside of the SRGB and certain areas of Fort Ord without the need for the Agency to obtain an injunction;

- H. To meet applicable requirements of the Agency Act, CAW has proposed as part of the MPWSP to make available for delivery to groundwater users overlying the SRGB a volume of water equal to the percentage of SRGB groundwater in the total MPWSP source water production, as determined by the Agency (“Return Water”);
- I. The SVWC, MCFB and Landwatch contend there is no surplus SRGB groundwater available for CAW’s use in providing public water service within or outside of the SRGB and that the law of California groundwater rights requires that any production and use of SRGB groundwater by the MPWSP must be returned for use within the SRGB in lieu of existing groundwater pumping;
- J. For MPWSP planning and engineering purposes, CAW submits that the MPWSP source water wells have been designed so that approximately 4% of the source water produced by the MPWSP will originate as brackish groundwater from the SRGB;
- K. For planning purposes, CAW has assumed that the Return Water volume for the large desalination plant will be 1,080 afa, and for the small plant 690 afa;
- L. The CPUC is conducting environmental review of the MPWSP under the California Environmental Quality Act (“CEQA”), and the Monterey Bay National Marine Sanctuary is conducting environmental review of the MPWSP under the National Environmental Policy Act (“NEPA”);
- M. The modeling used in the CPUC’s April 2015 CalAm Monterey Peninsula Water Supply Project Draft Environmental Impact Report (“DEIR”) estimates that the volume of SRGB groundwater produced as source water for the large-scale (9.6 million gallons per day) MPWSP would be approximately 7 percent, or 1,889 afa, under existing land-use conditions and would be approximately 4 percent, or 1,080 afa, under projected future 2060 land-use conditions, and would average approximately 5.5 percent, or 1,485 afa, over the life of the MPWSP. (DEIR at 4.4-67.)
- N. Note C to the CPUC’s DEIR Table 2-5 states that “groundwater modeling indicates that as much as 1,080 afa may need to be returned to the Salinas Valley Groundwater Basin (based on 4 percent of total source water intake being drawn from the Salinas Valley Groundwater Basin[])” and states that “MPWSP supply would be sufficient to provide this larger quantity of return water.”
- O. The CPUC is preparing a revised DEIR/Environmental Impact Statement (RDEIR/DEIS) for the MPWSP that will assess the significance of effects to SRGB groundwater resources, and the modeling in the revised RDEIR/DEIS will be updated and calibrated to include test well production data obtained to date (over 100 days of pumping). CAW also is working to gather additional (up to two years) test well production data to inform analysis of those effects. The full data set is not expected to be available before the CPUC’s completion of CEQA/NEPA review and its decision whether to approve a certificate of convenience and necessity for the MPWSP;
- P. The Parties and the State Water Resources Control Board are in agreement, and the DEIR

concludes, that injecting desalinated water from the MPWSP into the SRGB is less desirable than delivering the Return Water for beneficial use in in the SRGB;

- Q. Prior environmental analyses reveal that there may be limitations in the capacity of the Castroville Seawater Intrusion Project (“CSIP”) to accommodate all of the MPWSP Return Water under some conditions. (DEIR, p. 2-45, 6-4, 6-114; Pure Water Monterey, GWR DEIR, Appendix Q, Table B-3);
- R. CSIP is an Agency project that provides recycled water and diverted Salinas River water for use in lieu of groundwater pumping for irrigated agricultural use in the Castroville area of the SRGB;
- S. The CPUC Administrative Law Judge has requested additional testimony from the Joint Settling Parties regarding Return Water options, and that testimony must be submitted to the CPUC by January 22, 2016;
- T. The SVWC, MCFB and Landwatch contend that the MPWSP’s well production may cause injury to the SRGB and senior groundwater rights holders in the SRGB under California groundwater law, even if the RDEIR/DEIS concludes that the well production would not cause a significant adverse effect under CEQA.
- U. MCFB, SVWC and Landwatch oppose any scenario where Return Water would be used outside the SRGB, rather than for use in lieu of existing groundwater pumping in the SRGB;
- V. In the July 31, 2013 Settlement Agreement among 16 parties to Proceeding A1204019, MCFB, SVWC, Landwatch, the Agency, and Citizens for Public Water reserved all rights to challenge production of water from the SRGB by CAW in any appropriate forum based on their concerns for potential harm to the SRGB and users thereof;
- W. MCFB and SVWC have stated they will litigate these issues if they are not resolved through agreement;
- X. CAW and the Authority maintain that any obligation to return SRGB groundwater to the SRGB arises only as a requirement of the Agency Act, except to the extent that Return Water is necessary as part of a physical solution to avoid harm to the SRGB and senior groundwater rights holders in the SRGB under California groundwater law or to mitigate significant adverse effects to the SRGB or particular groundwater users pursuant to CEQA;
- Y. CAW, with the encouragement of the Authority, also desires to maximize revenue for Return Water to offset water costs and water rates for CAW customers on the Monterey Peninsula;
- Z. CAW must obtain CPUC approval to deliver or sell any Return Water for use outside of CAW’s service area;
- AA. A controversy has now arisen as to CAW’s obligation to deliver Return Water to the SRGB, and as to the responsibility for the costs of producing the Return Water, and the Parties to this Term Sheet desire to resolve these issues and to reach agreement on a framework to satisfy Return Water requirements;

- BB. Pursuant to the terms of this Term Sheet, the Parties propose that CAW deliver Return Water to the CCSD and to the CSIP to satisfy Return Water requirements that may arise out of the Agency Act, CEQA, or California groundwater law, in accordance with terms and conditions to be agreed upon based on the general principles contained in this Term Sheet;
- CC. CCSD submits that it provides municipal and domestic water service to the Town of Castroville, which overlies the SRGB in an area north of the City of Marina and west of the City of Salinas;
- DD. CCSD submits that it currently relies on groundwater from the SRGB to meet Castroville's water demands, which average approximately 800 afa;
- EE. CCSD submits that it increasingly has experienced water supply challenges due to water quality degradation of its water supplies, primarily from increased salinity;
- FF. CCSD submits that poor water quality, including elevated sodium levels extant in CCSD's groundwater supplies, can contribute to health risks of individuals susceptible to high sodium;
- GG. CCSD submits that it has been identified as a disadvantaged community (Greater Monterey County IRWM Regional Water Management Group Disadvantaged Community Outreach Plan, Prepared for the Environmental Justice Coalition for Water by Nilsen & Associates, Approved April 18, 2012), and was an active participant in the Regional Plenary Oversight Group process established by the Office of Ratepayer Advocates to determine whether the Regional Desalination Project, a predecessor project to the MPWSP, would be a source of supply for Castroville;
- HH. CCSD submits that many of CCSD's customers contribute significantly to agricultural and hospitality industries in the Salinas Valley and on the Monterey Peninsula;
- II. CCSD submits that it is actively pursuing alternative water supplies and has applied to the State for funding to develop deeper groundwater wells and other projects to serve its customer demands;
- JJ. CCSD submits that it is interested in taking delivery of a Return Water supply from the MPWSP to replace or supplement CCSD's current reliance on groundwater from the SRGB;
- KK. Preliminary cost estimates for a pipeline to convey water from the MPWSP plant to CCSD are approximately \$6,500,000, which may be reduced to approximately \$4,400,000, assuming that CAW will secure contracts for construction of the pipeline and that environmental review and permitting will be performed in conjunction with the MPWSP. CCSD submits that it may not be able to prudently fund a pipeline for more than \$2,800,000, and that capital obligations for the pipeline would necessitate long-term commitments by CCSD and certainty of source water supply for CCSD;
- LL. The SVWC, MCFB, and Landwatch support CAW's delivering Return Water to CCSD and to CSIP for use in lieu of existing groundwater pumping in the SRGB; and

MM. CAW's delivery of Return Water to CCSD pursuant to the terms of this Term Sheet is a fair and equitable resolution of the disputed matters described above, and is consistent with the law and policy controlling the CPUC's approval of the MPWSP.

NN. The foregoing Recitals are included to provide background regarding this Term Sheet but are neither part of nor incorporated into its terms.

NOW, THEREFORE, as a COMPROMISE and SETTLEMENT of the above-stated dispute, and to provide for an efficient and effective resolution of this dispute, the Parties do hereby AGREE to negotiate appropriate binding agreements on the following terms:

1. Notwithstanding any other provision of this Term Sheet, this Term Sheet sets forth agreements in principle concerning its subject matter, but does not at this time constitute binding covenants or conditions with respect to the issue of Return Water.
2. It is anticipated that certain Parties to this terms sheet will negotiate and enter into water purchase agreements under which CAW will deliver Return Water to the SRGB during the term of the anticipated water purchase agreements for use in lieu of existing groundwater production as follows:
 - a. CAW shall have annual Return Water requirements that shall be calculated based on the percentage of SRGB groundwater in the total MPWSP source water production for the prior calendar year ("Annual Return Water Obligation").
 - i. During the first three months after start-up of the MPWSP, the Annual Return Water Obligation shall be 7% of total source water production during that period, and for the remainder of that year shall be the percentage of SRGB groundwater in the total MPWSP source water production calculated during the first three months in which the MPWSP started up and then operated.
 - ii. Thereafter, CAW shall make available for delivery to the SRGB for beneficial use each year the Annual Return Water Obligation.
 - iii. The volume of the Annual Return Water Obligation shall be determined by the Agency based on the methodology set forth in Exhibit A [parties analyzing], which may include annual averaging and other operational parameters appropriate to the circumstances.
 - b. CAW shall make available for delivery to CCSD 800 afa of Return Water if the large desalination plant is constructed or 690 afa if the smaller desalination plant is constructed ("CCSD Delivery Volume").
 - c. If the Annual Return Water Obligation is less than the CCSD Delivery Volume, CAW shall make available for delivery potable water in addition to the amount of the Annual Return Water Obligation sufficient to satisfy the CCSD Delivery Volume ("Excess Water").
 - d. CAW shall make available for delivery to CSIP any Annual Return Water Obligation

in excess of the CCSD Delivery Volume, according to procedures agreed to in the Water Purchase Agreement.

3. The Parties acknowledge that CAW could be legally required by a regulatory agency, including the CPUC in this proceeding, or by a court, to make water deliveries to other locations in the SRGB to the extent necessary to mitigate any groundwater impacts from the MPWSP that were demonstrated in relation to a specific location overlying the SRGB (“Other Return Water Obligation”). Such Other Return Water Obligation could also serve to satisfy CAW’s obligations to return water to the SRGB under the Act, CEQA, or common-law water law principle. Under such circumstances, the Parties agree that it may be inequitable to CAW and its ratepayers to fund both the Other Return Water Obligation and the Return Water obligations specified herein as this would result in a duplicative liability to CAW and its ratepayers. CAW’s obligation to make available the CCSD Delivery Volume shall be reduced in the event and to the extent that a regulatory agency or court has required CAW to deliver Return Water in a manner or location different than as specified in the Term Sheet. CCSD shall not be obliged to purchase Return Water if it determines that the reduced amount of Return Water would not be sufficient to justify a Water Purchase Agreement as contemplated herein. In the event that CCSD determines that its water purchase is not justified due to an Other Return Water Obligation, the parties to this Term Sheet will meet and confer in good faith to effect other arrangements to make the remaining Return Water, net of the Other Return Water Obligation, available for use in lieu of existing groundwater pumping in the SRGB in order to ensure that CAW will meet its Annual Return Water Obligation under this Term Sheet.

The Parties further acknowledge that the CCSD must be assured of a specific volume of Return Water to justify investment in the capital facilities necessary to convey the Return Water from the Project to the CCSD (the “CCSD Facilities”), and therefore CAW’s obligation to the CCSD Delivery Volume specified herein cannot be terminated during the term of the anticipated water purchase agreements after such time as CCSD has obligated itself to finance such capital facilities. To afford the best foresight in relation to potentially competing Return Water obligations, while also facilitating the certainty relating to Return Water deliveries required by CCSD, CAW’s obligation to make available the CCSD Delivery Volume under the terms of that water purchase agreement shall become unconditional on the date that is the latest of the following dates:

- a. the date on which the CPUC has issued a CPCN for the Project and the period to challenge the legality of the CPUC’s issuance of the CPCN (based on CEQA compliance or otherwise) has expired and no challenge has been brought;
- b. the date on which any challenge against the CPUC’s issuance of the CPCN is resolved with finality following all available appeals and petitions; or
- c. 60 days following the date on which the CCSD provides notification to CAW that it has secured financing, acceptable to CCSD, to construct the CCSD Facilities.

In the event of any challenge against the CPUC's issuance of the CPCN, the Parties to this Agreement shall meet and confer in good faith to effect other arrangements to make the total amount of the Return Water, as adjusted by any Other Return Water Obligation, available for use in lieu of existing groundwater pumping in the SRGB in order to ensure that CAW will meet its Annual Return Water Obligation under this Agreement during the pendency of that litigation.

After the above dates, Cal Am may not terminate its obligation to deliver the CCSD Delivery Volume in the event CAW is subsequently required to make Other Return Water Obligations. CAW and CCSD shall meet and confer as necessary within a reasonable amount of time before or after any of the above dates if it appears that CAW's obligation to make available the CCSD Delivery Volume may not become unconditional. Due to the urgent nature of the MPWSP and other regulatory pressures to implement the MPWSP, CAW and CCSD may mutually agree at any time to amend and move forward with the CCSD Water Purchase Agreement, notwithstanding Other Return Water Obligations, provided all other required approvals have been attained and provided that CAW will meet its Annual Return Water Obligation under this Term Sheet through some combination of the CCSD Water Purchase Agreement, the CSIP Water Purchase Agreement, Other Return Water Obligations, or arrangements made pursuant to paragraph 6 of the Term Sheet.

4. Return Water and Excess Water pricing shall be as follows:
 - a. **CCSD:** For each acre-foot of Return Water or Excess Water made available for delivery to CCSD:
 - i. CCSD shall pay \$110 per acre-foot, as currently estimated, for Return Water made available for delivery to meet the Annual Return Water Obligation, which reflects its avoided cost to produce groundwater to meet customer demand.
 - ii. CCSD shall pay \$580 per acre-foot, as currently estimated, for any Excess Water, which reflects the operations and maintenance cost for the MPWSP to produce one acre-foot of potable water.
 - b. **CSIP:** For each acre-foot of Return Water delivered by CAW, CSIP shall pay \$xxx per acre-foot, as currently estimated, which reflects the CSIP customers' marginal avoided cost for recycled water produced for use by the CSIP in lieu recharge project's customers.
 - c. Payment for Return Water and Excess Water shall be subject to standard financing provisions, including appropriate price adjustments. The pricing set forth in this Term Sheet is for illustrative purposes only, and actual prices have not been determined.
5. The Parties support CAW negotiating and entering into Water Purchase Agreements with CCSD and the Agency (for CSIP) consistent with the terms of this Term Sheet.

- a. The Water Purchase Agreements shall have an initial term of at least 30 years.
 - b. Prior to the expiration of the Water Purchase Agreements contemplated herein, CCSD and CSIP shall have a right of first refusal to enter into new water purchase agreements on terms to be negotiated at the time.
6. CAW's obligation to make Return Water available for use in lieu of existing groundwater pumping in the SRGB to meet its Annual Return Water Obligation shall survive for a period of 30 years if the initial Water Purchase Agreements do not become effective or are otherwise amended or terminated. In that event, the Parties to this Term Sheet shall meet and confer in good faith to effect other arrangements to make the total amount of the Return Water reduced by any Other Return Water Obligation available for use in lieu of existing groundwater pumping in the SRGB in order to ensure that Cal-Am will meet its Annual Return Water Obligation under this Term Sheet.
7. Upon expiration or non-renewal of the Water Purchase Agreements: (a) CAW shall comply with the Agency Act; and (b) unless CAW demonstrates that Return Water is not needed to prevent legal injury to prior groundwater rights holders in the SRGB or to avoid significant adverse effects to SRGB groundwater resources pursuant to procedures to be agreed upon in future negotiations, CAW shall continue to make Return Water available for delivery to the SRGB for use in lieu of existing groundwater production. In the event of a dispute among any of the parties to this Term Sheet with respect to CAW's need to continue providing Return Water, such dispute shall be resolved by a dispute resolution procedure to be agreed upon in future negotiations.
8. This Term Sheet reflects a settlement and compromise of putative claims and remedies of the Parties hereto.
9. If the Return Water settlement described in this Term Sheet is not approved by the CPUC and implemented by CAW, the SVWC, MCFB and Landwatch reserve their rights to challenge CAW's production of water from the SRGB in any appropriate forum.
10. The Parties agree to support CPUC approval of MPWSP consistent with the compromise and settlement reflected in this Term Sheet, and agree to defend and support this Return Water settlement Term Sheet in any administrative or judicial proceedings concerning this Term Sheet and/or CAW's obligations and responsibilities with respect to Return Water.
11. Among other things, this Term Sheet helps to define a stable and finite project description that will facilitate the CPUC's completion of CEQA review for the MPWSP. The legal effectiveness of this Term Sheet is contingent on the completion of CEQA review and does not irretrievably commit the Parties to carrying out any physical activities that would be required for CAW to meet the Annual Return Water Obligation, including through the anticipated Water Purchase Agreements whose future approval will be conditioned upon the completion of CEQA review by the CPUC as lead agency for the MPWSP and by those Parties playing the role of a responsible agency with respect to the anticipated Water Supply Agreements. The lead agency and responsible agencies will retain full discretion with respect to deciding whether to approve Water Supply Agreements or any other commitments

necessary or convenient for CAW to meet the Annual Return Water Obligation, including discretion to modify commitments to avoid or reduce any significant adverse physical environmental effects from Return Water activities that are within their jurisdiction.

12. This Term Sheet does not currently impact the terms of sections 3.1(b) of the document known as the Large Settlement Agreement. To the extent later binding agreements may specifically do so, they will not impact the Agency's authority and responsibilities under the Agency Act.
13. This Term Sheet may be executed in any number of counterparts.

[Signatures to be added]