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DATE: July 28, 2009
TO: Mayor and City Council
FROM: Director of Public Works
SUBJECT: New Water Supply Agreement with San Francisco Public Utilities Commission

RECOMMENDATION

That Council adopts the attached resolutions approving the Water Supply Agreement and authorizing and directing the City Manager to execute the Agreement, and adopting findings for the purpose of the California Environmental Quality Act in connection with the approval of the New Water Supply Agreement with San Francisco.

BACKGROUND

The City of Hayward receives 100 percent of its water supply from the San Francisco Public Utilities Commission's Hetch Hetchy water system. This water supply is governed by two documents: 1) the 1962 contract between the City of Hayward and the San Francisco Water Department; and 2) the 1984 Settlement Agreement and Master Water Sales Contract between the San Francisco Public Utilities Commission (SFPUC) and its wholesale customers. The 1962 contract primarily addresses the quantity of water to be delivered to Hayward and, unlike all other similar contracts between SFPUC and other suburban agencies, does not have an expiration date. The Master Sales Contract focuses on issues that are common to all wholesale purchasers of SFPUC water, such as the setting of wholesale water rates and allocation of costs. The 1984 Agreement expired on June 30, 2009.

In October 2006, the City Council authorized Bay Area Water Supply and Conservation Agency (BAWSCA), a 28-member agency that consists of wholesale purchasers of SFPUC water, to represent the City in negotiations with SFPUC for a new water supply agreement. Negotiations were initiated in 2007 and concluded in March 2009. A copy of the proposed Agreement was released to the public, including affected wholesale agencies, on April 17. The SFPUC considered and approved the Agreement on April 28. The Agreement requires the governing bodies of each individual wholesale agency to consider the Agreement and decide whether or not to sign it. Although the current contract expired on June 30, the new Agreement allows wholesale customers to ratify it by September 1.

Attached as Exhibit A is a summary report on the new Water Supply Agreement prepared by the BAWSCA negotiating team.

DISCUSSION

Negotiations between the BAWSCA, on behalf of its member agencies, and the SFPUC regarding the new Water Supply Agreement have been concluded. This Agreement addresses issues of common interest to all wholesale purchasers of SFPUC water, such as the allocation of water supply, water supply quality, and allocation of costs. At this time, the SFPUC and all but one of the other wholesale customers have approved the new Agreement. The remaining wholesale customer is working with SFPUC to resolve issues related to its individual supply contract and is expected to approve the Water Supply Agreement when the issues are worked out.

Staff has completed its review of the Agreement. There are clearly some positive aspects, which are noted below. Staff has concerns about some other provisions. After reviews and discussions with BAWSCA General Manager and the BAWSCA legal counsel, staff finds that, on balance, the Agreement has enough merit to warrant a recommendation for approval. Chief among staff's concerns are potential long term adverse impacts of the new Agreement on Hayward's ability to purchase its needed supplies at a fair price, i.e., without having to pay penalties that would make the already high projected cost of the Hetch Hetchy water even more expensive.

Positive aspects - As indicated above, the New Water Supply Agreement includes a number of provisions that are positive and a clear improvement over the existing Agreement. Briefly the positive features include:

Completion of Water System Improvement Program (WSIP) - The Agreement will commit San Francisco to complete WSIP by 2015. While this is positive, it is noteworthy that this aggressive schedule (which wholesale agencies wanted and directed BAWSCA to pursue through adopted legislation) does mean that the wholesale cost of water will increase rapidly, commensurate with the fast track schedule of the construction of the improvements. As the Council is aware, the average increase in cost of wholesale water in the next five years is over 17% per year. This cost must be passed on to City customers.

System Maintenance - The Agreement will require SFPUC to maintain the system in good order and repair.

Water First - The Agreement will commit SFPUC to continue its "water first" policy, i.e., operating the Hetch Hetchy reservoirs in a way that gives higher priority to water delivery and environmental values, than to electrical power generation.

Wheeling - The Agreement allows BAWSCA and/or wholesale customers to wheel water from outside sources through the SFPUC regional system.

Meet Safe Drinking Water Act Standards - The Agreement will commit SFPUC to deliver drinking water meeting the primary drinking water standards. While SFPUC has always done this, the

provision will ensure that this continues to be the case regardless of changes in regulations or other changes in the future.

Issues of Concern - The Agreement also includes several issues that have been, to various degrees, of concern to staff. As indicated below, we have found acceptable resolutions or workarounds to most of them. The first two issues are of significant consequence to the City. The highlights of the issues of concerns include:

Transferability of Supply Guarantees and the Fact that Hayward Is Not Allowed to Participate -

The Agreement will allow wholesale customers to transfer, on a permanent basis, portions of their individual supply guarantees among themselves. Presumably, this could be done by agencies that have supply guarantees well above their projected long-term needs, or by those agencies that are willing to develop other water supplies, such as groundwater and recycled water, to free up their SFPUC supply guarantees. This has potentially a couple of adverse impacts on Hayward:

1. Because Hayward is the only wholesale customer without a pre-set cap in the amount of water to which the City is entitled, there is no "Supply Guarantee," as such, for Hayward. Hayward uses what it needs. If a situation arises whereby Hayward's use and the cumulative use of the other wholesale customers reaches 184 million gallons per day, the City's original Agreement with SFPUC requires that other wholesale agencies cut back to accommodate Hayward's needs. One can argue that allowing agencies to transfer their capacities to others could, in the long term, diminish the unused water supplies that are practically available to Hayward.

Counterpoints to this argument are that: a) agencies may be reluctant to sell "excess" capacities because, in the long term, that is not a prudent thing to do; and b) this ability to transfer supplies could act as an incentive for agencies to invest in producing alternative water supplies, such as recycled water and ground water, so they can then transfer an equivalent amount of Hetch Hetchy (or alternative source) water.

2. Likewise, because Hayward does not have a "Supply Guarantee," the Agreement excludes Hayward from participation in the permanent transfers. While it is perfectly clear that Hayward cannot be given authority to sell an allocation that is unlimited, it is staff's position that the City should be able to sell the equivalent of any alternative supply in which it invests and develops, such as recycled water and ground water. The new Agreement does not explicitly authorize that.

It appears that there might be some legal and procedural issues that need to be worked out as part of a comprehensive solution to this issue. At this time, however, there is no readily available solution to this issue to allow Hayward to be on par with other agencies, although there is an apparent commitment from BAWSCA staff to work on an acceptable solution to this issue.

Interim Limit of 184 MGD through 2018 - It is a fact that, without significant additional conservation, the consumption from all wholesale customers, including the temporary and interruptible customers (i.e., San Jose and Santa Clara) will reach 184 MGD, which is the total

Supply Assurance for wholesale customers, sometime well before 2018. In order to respond to the environmental community's desires not to take more water from the Tuolumne River and in order to ensure that completion of the improvements called for in the Water System Improvement Program progresses unimpeded, San Francisco decided on the unilateral imposition of this limitation. In order to live within the 184 MGD limitation while accommodating San Jose and Santa Clara's needs, every agency's water supply will be subject to a limitation set forth by SFPUC. In the event that the supply limitation is exceeded in a given year on an overall, system-wide basis, agencies that exceed their individual allocation will be subject to significant environmental surcharge fees.

This has always been a major concern of staff. This provision, which could be extended beyond 2018, can, in effect, create a de facto limit for Hayward, which, as the Council is aware, does not otherwise have a pre-set limit, although it is also true that other BAWSCA agencies would have to reduce consumption to fulfill Hayward's supply demands.

Given that BAWSCA's position was that San Jose's and Santa Clara's temporary and interruptible water service should continue and not be stopped, and that San Francisco did not offer to provide for these two agencies' consumption (totaling about 9MGD) outside of the 184 MGD supply guarantees, there were not many other alternatives. The reality is that the water from Hetch Hetchy is finite and, therefore, there is a practical limitation on Hayward's consumption. Hayward's best option is to remain engaged with BAWSCA staff and BAWSCA Board to make sure that, not only does the City continue to be a leader in water conservation and low residential per capita consumption, but that other agencies also conserve more and reduce their usage.

Water Management Charge - The new Agreement will commit SFPUC to collect a "water management charge," if and when such a charge is established by the BAWSCA Board of Directors, and remit those funds to BAWSCA to support regional water conservation measures and development of alternative supplies approved by the BAWSCA Board of Directors.

While staff continues to be concerned about any reduction in the Council's full prerogative and authority in implementation of water conservation in the City, we can appreciate some benefits of a region-wide effort that could be funded by this mechanism. Again, the key is for Hayward to be actively and constructively engaged with BAWSCA agency to have an effective voice in the decisions and to insure there is a reasonable return to the City of what its customers pay into the program.

Additional Administrative and Ministerial Authority to BAWSCA - The new Agreement transfers some existing individual agency authority or creates new authority for the BAWSCA Board or BAWSCA staff, such as deciding on the individual agency water shortage allocations. While this could be construed as less than desirable, staff believes that, with active and constructive participation in BAWSCA, the City can have an effective voice in the decisions made.

Amendments to the Agreement - The 1984 contract is extremely difficult to amend, requiring concurrence by a very large super-majority of the wholesale customers. This, in effect, meant that Hayward is one of the agencies that had an effective veto power on changes that would have an undesirable impact on the City. The new Agreement reduces the threshold so that no individual agency has that power.

While this provision could be undesirable, it underscores the need for the City to be more pro-active and work with other agencies to develop consensus on issues of concern to Hayward.

Options Available to the City: To Sign or Not to Sign - The City clearly has the option not to sign the new Agreement. If the City opts not to sign, it will be entirely subject to the provisions of the City's 1962 individual water service Agreement. While in practical terms the City will be subject to more or less the same terms and conditions as others, whether or not it has signed the new Agreement, the City might, in some narrow situations, be worse off by not signing the Agreement. For example, the City may not have as clear a claim to the provisions mentioned earlier under the positive impacts of the new Agreement.

BAWSCA staff and legal counsel have been very clear in their recommendation that Hayward should sign the new Agreement. In their opinion, there are more positive than negative aspects for Hayward.

The City Attorney concurs with the staff recommendation that the proposed agreement contains more positives than negatives but observes the agreement will likely go into effect with or without Hayward's affirmative approval. The City Attorney believes the City would be in a better position to protect and assert its interests if it approves the agreement.

Environmental Documentation - With regard to the adoption of findings in connection with approval of the Water Supply agreement, the City and County of San Francisco is the "lead agency" under the California Environmental Quality Act (CEQA) with respect both to the Water System Improvement Program (WSIP) and the water supply elements incorporated into the New Water Supply Agreement. In that capacity, San Francisco has prepared and certified a seven-volume Program Environmental Impact Report, adopted detailed findings related to the environmental effects of the "Phased WSIP" approved by the SFPUC in October 2008, mitigation measures, and overriding considerations. As a Wholesale Customer, the City may be considered a "responsible agency" under CEQA with respect to one aspect of the overall project analyzed in the Program EIR, namely the approval of the long term WSA. Upon approval of the WSA, a Notice of Determination will be signed and filed with the County Clerk of Alameda County.

FISCAL AND ECONOMIC IMPACT

Signing the Agreement will not affect the wholesale cost of water. However, as Council is aware, wholesale rates are projected to increase an average of 17% per year over the next five years as a result of constructing the needed regional system improvements. It is unknown, at this time, what the impact of potential "water management charges" may be. However, whatever charges are added to the wholesale rate may need to be passed on to City customers, depending on whether they replace already budgeted City water conservation programs.

NEXT STEPS

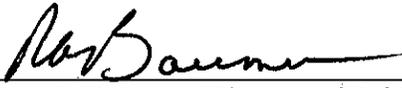
If Council agrees with staff's recommendation and approves the Agreement, staff will process the attached resolution and transmit the Agreement to SFPUC for further processing.

Prepared by:



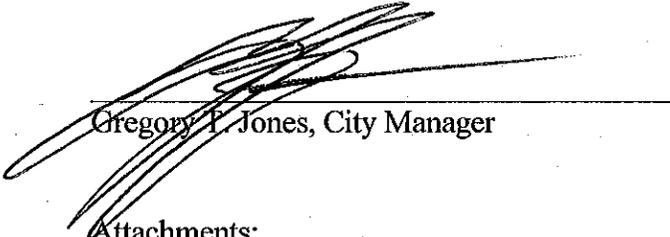
Alex Ameri, Deputy Director of Public Works

Recommended by:



Robert A. Bauman, Director of Public Works

Approved by:



Gregory T. Jones, City Manager

Attachments:

- Exhibit A: Summary Report on the New Water Supply Agreement
- Draft Notice of Determination
- Draft Resolutions

Summary Report
on
New Water Supply Agreement
Between the City and County of San Francisco
and
Wholesale Customers in Alameda, San Mateo and Santa Clara Counties

Prepared for
San Francisco Bay Area Water Supply and Conservation Agency

By
Ray McDevitt and Allison Schutte
Hanson Bridgett LLP

April 2009

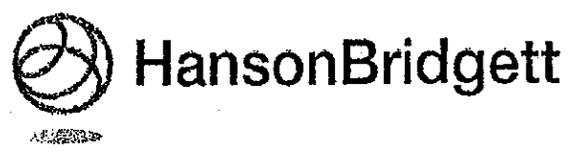


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SUMMARY REPORT ON NEW WATER SUPPLY AGREEMENT

INTRODUCTION

This report was prepared at the request of the Bay Area Water Supply and Conservation Agency (BAWSCA). Its purpose is to provide a summary of the major provisions in the new Water Supply Agreement which BAWSCA has negotiated with representatives of the San Francisco Public Utilities Commission (SFPUC or Commission) and which was approved by the Commission on April 28, 2009.

In 1984, San Francisco and all of its wholesale customers entered into a "Settlement Agreement and Master Water Sales Contract," the term of which was 25 years and which will expire on June 30, 2009. This is a lengthy document which was executed in multiple identical counterparts by San Francisco and each of its wholesale customers. It was titled a "Settlement Agreement" because it settled a lawsuit brought by several of the wholesale customers against San Francisco, which is described in the opinion in *Palo Alto v. San Francisco* (9th Cir. 1977) 548 F.2d 1374, decided by the United States Court of Appeal for the Ninth Circuit.

The 1984 Settlement Agreement and Master Water Sales Contract was negotiated by the Bay Area Water Users Association (a less formal predecessor to BAWSCA) with support from attorneys, engineering consultants, municipal financial consultants, and CPAs.

A similar approach has been taken in preparation of the new Agreement. In 2006, BAWSCA offered its services as negotiator of the new Agreement. The governing boards of all 27 wholesale customers adopted resolutions delegating that authority and prescribing the parameters of that delegation. BAWSCA has conducted the negotiations with the SFPUC starting in 2007. The negotiating team has been led by Art Jensen, BAWSCA's General Manager/CEO. Mr. Jensen holds a Ph.D. in engineering from Cal Tech and has spent his career consulting for, and managing, urban water agencies. He has been assisted by BAWSCA's staff engineer Nicole Sandkulla, and staff financial analyst John Ummel, as well as

by independent engineering, financial and accounting consultants.¹ Attorneys at Hanson Bridgett have served as legal counsel to the BAWSCA negotiating team and were the principal drafters of the Agreement. Bud Wendell has provided strategic guidance at critical junctures.

The Agreement's Introductory Statement provides that both San Francisco and its wholesale customers "share a commitment to the Regional Water System providing a reliable supply of high quality water at a fair price and achieving these goals in an environmentally sustainable manner." Part One, Sections A, B, C and H of this report cover provisions in the new Agreement which address water supply reliability. Part One, Section D focuses on the Agreement's provisions related to water quality. Part Two covers the considerable portion of the new Agreement designed to ensure that the capital and operating costs of the regional water system are fairly allocated between San Francisco's retail customers and the wholesale customers. Finally, Part One, Sections E and F.2 summarize provisions in the Agreement explicitly addressing water conservation and use of alternative local sources of water.²

PART ONE **WATER SUPPLY (Articles 3 and 4 of Agreement)**

A. Quantity

1. Supply Assurance Reconfirmed. The Agreement reconfirms San Francisco's perpetual commitment to deliver 184 million gallons per day (MGD), on an annual average basis, to the wholesale customers collectively, other than San Jose and Santa Clara (the "Supply Assurance"). It also preserves the wholesale customers' claim that San Francisco

¹ Engineering support has been provided by Allan Richards, P.E., with Stetson Engineers. Financial support has been provided by Dan Cox and David Brodsky, both with KNN Financial, and by John Farnkopf, with HF&H Consultants. Assistance on accounting/auditing aspects of the Agreement has been provided by Steve Mayer, CPA, and Jeff Pearson, CPA, with Burr, Pilger & Mayer, LLP.

² In addition, Part One, Section G describes the mechanics through which the SFPUC intends to implement the Commission's decision in October 2008 to impose a limit on deliveries to 265 MGD through 2018 and to enforce the interim supply limitations assigned to individual agencies through Environmental Enhancement Surcharges.

is obligated to provide water over and above the Supply Assurance, as well as San Francisco's denial of that obligation.

2. Allocation of Supply Assurance Incorporated. The Agreement also incorporates and formally reconfirms the allocation of the collective 184 MGD Supply Assurance among the wholesale customers which was effected under the 1984 Contract (partly through triennial "vesting" and then by unanimous agreement of all agencies in 1994). The Agreement includes, as an attachment, a list of the individual "Supply Guarantees" for each of the 24 wholesale customers that currently have one.³

3. Transferability of Supply Guarantees. The Agreement allows wholesale customers to transfer, on a permanent basis, portions of their individual Supply Guarantees among themselves. These transfers are subject to only very limited San Francisco oversight to ensure Raker Act compliance and adequate physical capacity of the San Francisco regional system to deliver the additional water to the transferee agency.

B. Reliability

1. WSIP Completion. The Agreement commits San Francisco to complete the Water System Improvement Program (WSIP) approved by the Commission in October 2008 by 2015.⁴ In addition, the Agreement obligates San Francisco to provide full public review and opportunity for wholesale customers to comment on any proposed changes to the WSIP that would delay completion or delete projects. Finally, the staff of the SFPUC will meet and confer

³ These quantified supply guarantees will remain subject to pro rata reduction if and when collective use exceeds 184 MGD due to growth in demand, in order to preserve Hayward's claimed entitlement under its 1962 contract and the overall limit on San Francisco's commitment of 184 MGD. The Agreement will also preserve other agencies' reservation of their right to challenge this reduction.

⁴ This commitment is conditional on SFPUC's completion of all CEQA analysis and documentation required for the individual facilities that collectively comprise the WSIP. It is also made subject to a "force majeure" clause that excuses both SFPUC and the wholesale customers from delays in performance, or failure to perform, due to "acts of God" and other circumstances not the fault of, and beyond the control of, the affected party that make performance impossible or extremely impracticable.

with BAWSCA before proposing to the Commission any changes in scope that would reduce the ability of the regional system to meet level of service goals adopted by the Commission.

2. System Maintenance. The Agreement requires the SFPUC to keep the regional system in good working order and repair, consistent with prudent utility practice. SFPUC will prepare and publish bi-annual reports on the "State of the Regional System," will cooperate with any audits of system repair/maintenance conducted by BAWSCA, will consider the findings of such audits, and will provide responses, including reasons why any audit recommendations were not adopted.

3. "Water First." The Agreement commits the SFPUC to continue its "water first" policy, i.e., operating the Hetch Hetchy reservoirs in a manner that gives higher priority to delivery of water to the Bay Area, and to environmental values, than to electric power generation. It leaves day-to-day operational decisions up to the SFPUC.

C. Shortages

1. Drought. The Agreement continues the allocation of water between San Francisco and the wholesale customers which was agreed to in 2000 and memorialized as "Tier One" of the Interim Water Shortage Allocation Plan. The provisions of the Plan that allow wholesale customers to "bank" drought allocations and to transfer them are continued, while some of the procedures and schedules contained in the Plan have been updated. The "Tier Two" allocation of water among the wholesale customers themselves, scheduled to expire on June 30, 2009, is not made a part of the new Agreement with San Francisco. The SFPUC, however, is obligated to honor any new allocation agreed to by the wholesale customers, either unanimously or through BAWSCA.

2. Disaster. The Agreement requires the SFPUC to distribute water on an equitable basis after an earthquake or other natural disaster. The SFPUC response to disasters is to be guided by the Emergency Response and Recovery Plan (ERRP) adopted by the

SFPUC, the fundamental principles of which are incorporated into the Agreement itself. The ERRP is to be periodically reviewed and may be amended by the Commission. SFPUC staff will be required to provide 30 days notice to the wholesale customers of any proposal to amend the ERRP, along with the text of the proposed amendments.

3. Localized Reductions. Provisions in the existing 1984 Contract governing localized shortages due to isolated damage or system repairs are continued.

4. Wheeling. The Agreement allows for BAWSCA and/or wholesale customers to "wheel" water from outside sources through the SFPUC regional system during periods of shortage, subject to provisions regarding water quality impacts and cost reimbursement.

D. Water Quality

1. Meet Safe Drinking Water Act Standards; Notice. The Agreement commits the SFPUC to deliver treated water meeting federal and state primary drinking water standards: maximum contaminant levels (MCL's) and treatment techniques. The next update of the SFPUC Water Quality Notification and Communication Plan will include expanded coverage of secondary MCL exceedances. The SFPUC will provide notice to wholesale customers of any exceedance concurrently with notice provided to operators of the In-City retail distribution system.

2. Joint Water Quality Committee. A Water Quality Committee will be established, composed of a representative from the SFPUC and from each wholesale customer. The committee will meet at least quarterly to collaboratively address water quality issues. The Committee's Chair and Vice Chair will rotate between SFPUC and the wholesale customers.

E. Conservation

1. Wholesale Customers. The Agreement commits the wholesale customers to take actions, within their legal authority, regarding water conservation that are necessary to ensure that the SFPUC remains eligible to receive state and federal grants and other financial assistance and to participate in the State Drought Water Bank.

2. SFPUC Support for BAWSCA Conservation Programs. The Agreement commits the SFPUC to collect a "water management charge," if and when such a charge is established by the BAWSCA board of directors, and to remit those funds to BAWSCA to support regional water conservation measures and development of alternative supplies approved by the BAWSCA board of directors.

3. The "Green Option" to be Explored. The Agreement commits San Francisco to work with BAWSCA to explore ways to support water conservation and recycling in locations outside the Bay Area. This will include a particular focus on agricultural conservation/efficiency projects of the type described in the "Green Option," recommended by BAWSCA in its comments on the Program Environmental Impact Report on the WSIP, which can benefit the Tuolumne River.

F. Operational Issues

1. Service Areas. The Agreement continues existing restrictions on sales of water outside wholesale customers' service areas.⁵ It clarifies and continues the existing contract provisions regarding expansion of service areas (SFPUC approval is needed, but cannot be withheld unreasonably) and sales to other wholesale customers (pre-approved in emergencies; otherwise SFPUC approval is needed, but cannot be withheld unreasonably).

⁵ The service area maps will be updated and attached to each agency's new individual Water Sales Contract. (Each wholesale customer has, and will continue to have, two contracts with San Francisco. One is the lengthy Water Supply Agreement which is identical for each agency. The other is a much shorter document that addresses the specifics for each agency: its service area map, connections to the regional water system, interties with neighboring agencies, etc.)

2. Use of Local Sources. The Agreement extends the "best efforts" commitment to use of local sources to the SFPUC as well as the wholesale customers. Local sources include surface water, groundwater and available recycled water. The contractual obligation is subject to considerations of economic feasibility and the environmental and water supply reliability impacts of using these local sources.

3. Purchases from Third Parties; "Take or Pay" for Dual Source Agencies. The Agreement continues the prohibition on purchases from other sources if the SFPUC is able and willing to supply all water needed. It also expands exceptions to this prohibition by making it inapplicable to purchases of recycled water. In other words, wholesale customers that do not have direct access to a source of recycled water – i.e., a sewage treatment plant – may purchase from those that do.

The Agreement also allows the "dual source" agencies (Alameda County Water District, Milpitas, Mountain View, and Sunnyvale) to continue purchases from other suppliers, such as the California Department of Water Resources and the Santa Clara Valley Water District, subject to a required minimum purchase from SFPUC. These minimum "take or pay" commitments have each been reduced by five percent from current levels. Minimum purchase requirements in San Jose's and Santa Clara's current individual contracts are to be deleted in their new individual contracts. Also, the new Agreement makes clear that wholesale customers are not obligated to purchase water from SFPUC in amounts larger than their individual Supply Guarantees.

G. Interim Limit of 184 MGD Through 2018

1. No Decision by SF on Increase in Supply Assurance until 2018. The Agreement recognizes the SFPUC's unilateral decision made last October to defer any consideration of an increase in the 184 MGD Supply Assurance until 2018. It requires the SFPUC to make that decision by December 2018, after completing necessary cost analyses and CEQA evaluation/documentation. The Agreement does not constitute concurrence by

wholesale customers in SFPUC's limitation and also preserves the wholesale customers' claim that they are legally entitled to water in excess of 184 MGD.

2. Interim Limit on Sales until 2018. In October 2008, San Francisco independently established a self-imposed limit on sales of water from surface watersheds to 265 MGD until 2018. At the same time, it also established subsidiary limits of (a) 81 MGD for City retail customers and (b) 184 MGD for all 27 wholesale customers, including San Jose and Santa Clara.

Another element of this limitation, also adopted by the SFPUC in October 2008, is a schedule for allocating the 184 MGD interim limit among all wholesale customers: those allocations will be decided on by the Commission in December 2010.⁶

The SFPUC also decided last October that it will enforce these interim limitations through an "environmental enhancement surcharge" to be applied to purchases over 81 MGD (by City retail customers) or over the individual limitations assigned to each of the 27 wholesale customers, if and when total use exceeds 265 MGD.

The Agreement recognizes all of these decisions and provides procedural rules for establishing the interim limitations and surcharges and for the use of funds generated by the surcharges. It also allows wholesale customers to transfer portions of these interim limits among themselves, again subject to very limited SFPUC oversight. But it does not constitute wholesale customers' concurrence in the interim limitations themselves and preserves wholesale customers' ability to challenge the limitations assigned to them, and the imposition of surcharges, in court.

Some of the mechanics that are included in the Agreement include:

- The amount of the environmental surcharge will be established by the SFPUC during the spring of 2011 and the surcharges will become operative in FY 2011-12.

⁶ These allocations are entirely distinct from the permanent "Supply Guarantees." For example, they will apply to all 27 agencies, will last only until 2018, and their only purpose is to determine when the surcharge described in the immediately following paragraph in the text will apply.

- Whether or not to levy the surcharge will be determined after the close of each fiscal year and will apply only if total sales during that year exceeded 265 MGD.
- If the 265 MGD threshold is exceeded, then the surcharge will apply only to wholesale customers that purchased more than their interim limitation, and only to quantities in excess of that limitation. The amount due would be determined after the close of each fiscal year (beginning with FY 2011-12) and would be paid in equal monthly installments over the balance of the following fiscal year (beginning with FY 2012-13).
- Funds raised by the surcharge will be deposited in a restricted reserve fund, not subject to transfer to the SF General Fund, and will be expended only on environmental enhancement measures in the SFPUC's Sierra and local watersheds. (Surcharges are not due unless and until this restricted reserve fund is established by ordinance of the San Francisco Board of Supervisors.)
- Specific projects to which the funds will be directed will be decided by SFPUC's General Manager and BAWSCA's General Manager/CEO, after soliciting input from interested members of the public, including environmental groups.

3. Status of San Jose and Santa Clara. The Agreement provides that both cities will remain temporary and interruptible customers until 2018. The maximum amount that the SFPUC will deliver to them collectively until 2018 is 9 MGD. Their interim limitations, described in the preceding section, when assigned in December 2010, may be lower. SFPUC water may be used only within the two cities' existing service areas (the northern portions of each city).

- Starting in December 2010, the SFPUC will annually consider a report which will include water demand projections and conservation work plans through 2018. If the SFPUC decides, on the basis of that report, that the 265 MGD limit will not be achieved in 2018, it may issue a conditional notice of reduction, or interruption, in supply to San Jose and Santa Clara.

- Deliveries will not be reduced or terminated until the SFPUC has completed the required CEQA process and will not occur for the longer of (1) five years from the notice or (2) two years from completion of the CEQA process.

- The SFPUC will decide by December 2018 whether long term supplies are adequate to serve San Jose and Santa Clara, as well as the SFPUC's retail and other wholesale customers and, if so, whether to make the two cities permanent customers.

H. Limits on SFPUC Taking on New Customers.

Before 2018, San Francisco may not take on any new wholesale customers (1) until it has completed CEQA review, and (2) unless San Jose and Santa Clara are concurrently made permanent customers and the Agreement is amended to accommodate their addition.

After 2018, San Francisco may not take on any new wholesale customers (1) until it has completed CEQA review, (2) unless system reliability is improved and (3) unless San Jose and Santa Clara are made permanent customers and the Agreement amended.

San Francisco may not take on new retail customers, outside City boundaries, except in areas adjacent to existing retail customers and no more in aggregate than 0.5 MGD additional demand.

I. BAWSCA Involvement in SFPUC Planning for New or Alternate Supplies

If regulatory or other events impact San Francisco's ability to maintain the Supply Assurance from its existing surface water supplies, it may develop substitute supplies, and will collaborate with the wholesale customers in doing so. If, after 2018, San Francisco elects to increase the Supply Assurance using water from its existing surface water supplies, it may charge the wholesale customers in accordance with the cost allocation provisions of the Agreement. If San Francisco seeks to develop new sources to increase the Supply Assurance, engineering studies and ensuing water supply projects will be conducted jointly with BAWSCA under separate agreements specifying the purpose of the project, anticipated regional benefits, and how costs will be allocated.

PART TWO
COST (Articles 5, 6 and 7 of Agreement)

A. Overview

1. Basic Principles Unchanged. The fundamental cost allocation principles underlying the 1984 Contract are continued in the new Agreement. These include:

- Wholesale customers should not pay for SFPUC programs/facilities that are used only in the generation/transmission of electric power or only in the collection/treatment of San Francisco wastewater.
- Wholesale customers should not pay for Water Enterprise programs/facilities that benefit only SFPUC's retail water customers, both inside and outside of San Francisco.
- Wholesale customers and City retail customers should both pay for costs of building and operating the regional water system, from which they both benefit.
- The costs of the regional water system which should be shared include:
 - The costs of building and operating the water-related facilities in Hetch Hetchy (e.g., the pipelines).
 - An appropriate share of the costs of building and operating joint facilities in Hetch Hetchy (e.g., the dams).
 - The costs of building and operating facilities for transmission, storage and treatment of water located in Alameda, Santa Clara, and San Mateo Counties, and the three terminal reservoirs in San Francisco.
 - An appropriate share of costs incurred inside San Francisco, but that benefit the regional water system (e.g., costs of various SFPUC bureaus that support the operating departments and San Francisco Water Enterprise's own administrative and general costs).
- The cost of the regional water system should be divided between the City retail customers and wholesale customers based on their proportionate annual use of water delivered by the Regional Water System.

2. Basic Implementing Rules and Practices Unchanged or Improved. Water usage will be determined by accurate, well-maintained and regularly-calibrated meters. The standards for meter accuracy are now spelled out in the Agreement, as are the procedures and schedules for maintenance and calibration of meters.

Costs will be determined by SFPUC's maintaining a system of accounting, consistent with Generally Accepted Accounting Principles as applied to governmental enterprises, that allows for the costs that are properly chargeable to the wholesale customers to be separated from those that are not.

The annual amount due from all wholesale customers (the "Wholesale Revenue Requirement") will be determined by applying the Agreement's detailed cost allocation rules to the costs actually incurred, based on actual water usage by City retail and wholesale customers during each fiscal year. That amount will be compared to revenues actually billed to wholesale customers for that year. The difference will be posted to a "balancing account." If wholesale customers were charged more than the amount calculated to have been due, the overcharge will be entered as a credit in the balancing account. Conversely, if wholesale customers were billed less, the undercharge will be recorded in the balancing account and may be recovered in future years' rates. Amounts in the balancing account, whether positive or negative, will earn interest at the same rate as SF's pooled investment funds.

3. Changes in Methodology Primarily Relate to Capital Costs. There have been few changes in calculating and allocating operation and maintenance ("O&M") costs. More substantial changes have been made in the treatment of administrative and general ("A&G") costs. But these are largely efforts to simplify calculations and are not expected to have a major impact on the Wholesale Revenue Requirement.

By contrast, the new Agreement makes significant changes in how wholesale customers contribute to repayment of funds advanced by San Francisco to construct capital assets. The 1984 Contract adopted the "utility method" of recovering capital investments. Under this approach, wholesale customers paid depreciation and a return on the net book value of assets in the rate base. The new Agreement replaces the utility method with the "cash method" on a going-forward basis. Under this method, wholesale customers will pay

their proportionate share of SFPUC's annual debt service payments and capital improvements funded out of revenues.

The Agreement greatly simplifies the wholesale customers' repayment of their share of assets already built and in service as of June 30, 2009. Instead of calculating the amount due each year, the new Agreement provides for specified level payments over 25 years. The result will be that wholesale customers will have fully paid off their share of the existing "rate base" (about \$382 million) in 2034, rather than continuing to pay down the amount due over the assets' useful lives - which in many cases could extend decades past that date. Please see Section B.5 below for a more detailed description of the approach to capital costs in the new Agreement.

In addition, the tables which appear at the end of this report, and which are also incorporated into the Agreement itself, illustrate the application of the cost allocation rules in Section B as applied to budgeted costs for the next fiscal year (FY 2009-10).

B. Individual Cost Categories

1. Operating and Maintenance ("O&M") Expenses. There are five subcategories of O&M expenses:

(i) Source of Supply: Regional system costs will continue to be allocated on the basis of annual proportional usage. The Agreement will reaffirm the general principle that the location of facilities determines their classification as City Retail or Regional. This is important since San Francisco plans to construct water recycling and groundwater projects inside the City in the immediate future. Absent negotiated clarity in the Agreement, those facilities could have been asserted to have value for all customers; and their costs (both capital and operating) allocated in part to wholesale customers. The proposed South Westside Groundwater Basin conjunctive use project (in which Cal Water, Daly City and San Bruno are

jointly participating with SFPUC) will be considered a Regional project because of the benefits it will provide to the Regional System (i.e., all customers) during drought.

(ii) Pumping: Costs of operating and maintaining pumping facilities outside San Francisco will continue to be allocated on proportional annual usage.

(iii) Purification: Because the treatment plants are located outside the City, all costs associated with them have been, and will continue to be, classified as Regional and allocated on the basis of proportional annual usage. The new Agreement requires that expenses associated with the Water Quality Division's laboratories be fairly allocated between the Wastewater Enterprise and the Water Enterprise, with only the latter being reallocated between City Retail and Regional customers. Also, the costs allocated will be further reduced by revenues received for work done by the laboratories for third party customers.

(iv) Transmission and Distribution ("T&D"): The expenses in this category are divided between City Retail and the Regional system based on geographic location with one exception: the three in-City terminal reservoirs are considered components of the regional system. This classification is appropriate and will continue, as will allocation of Regional T&D costs on proportional annual use.⁷

(v) Customer Accounts: Currently all SFPUC Customer Accounts expenses are divided 98% to City and 2% to wholesale customers. The new Agreement provides that only the Water Enterprise's share of Customer Accounts will be included; the cost of Customer Accounts for Wastewater and Hetch Hetchy Water and Power will be excluded. The 98/2 percent allocation will continue, applied to that smaller amount.

⁷ There will be two changes, both requested by the City. Engineering and supervision expenses incurred outside the City, in the Water Supply and Treatment Division, are currently classified as A&G, unlike those incurred inside the City, which are treated as City Distribution Division O&M. BAWSCA has agreed to change the treatment so that these expenses are uniformly classified as O&M, provided that some in-City costs currently classified as Regional A&G are reclassified as City Retail. A similar treatment will apply to vehicle and building maintenance expenses.

2. Property Taxes. San Francisco Water Enterprise properties and improvements in Alameda, San Mateo and Santa Clara Counties are subject to property taxes levied by those counties. The 1984 Contract classifies 100% of these tax payments as Regional and allocates them between City Retail and wholesale customers on the same basis that most O&M expenses are allocated -- proportional annual water use. The new Agreement continues this, as well as the focus on net taxes; that is, tax refunds and taxes that are paid by tenants of City properties such as golf courses will be excluded.

3. Administrative and General ("A&G") Expenses. There are three subcategories within this classification:

(i) City Overhead: This category consists of expenses of support services provided by the City's central services departments that are not billed directly to the SFPUC. City overhead is allocated to the City's operating departments through the Countywide Cost Allocation Plan ("COWCAP") prepared by the City Controller.

For technical reasons no longer relevant, the parties in 1984 adopted a surrogate dollar amount, inflated each year by the CPI, in lieu of the COWCAP. The current contract allowed the parties to revisit this issue every five years, but both the City and wholesale customers have been satisfied to stay with the annually-inflated "deemed overhead" amount. The reasons for the initial adoption of the surrogate amount no longer apply. Moreover, San Francisco presented data showing that the "deemed overhead" figure had not allowed it to fully recover general City overhead as determined by the Controller and argued for using the actual COWCAP figure in the future. BAWSCA agreed.

(ii) SFPUC Bureaus: This subcategory consists of support services provided by the various SFPUC bureaus (e.g., Finance, Information Technology, Human Resources, etc.) to the three operating departments (or "enterprises" as they are now called). The current contract provides that SFPUC will allocate federally reimbursable costs in

accordance with an "Indirect Cost Allocation Plan" approved by the U.S. Department of Health and Human Services. Costs that are not federally reimbursable are to be allocated in accordance with a detailed list of metrics. This arrangement is no longer functional. The SFPUC no longer submits an Indirect Cost Allocation Plan to the federal government and hasn't done so for many years. And the allocational metrics specified in the Contract, while reasonable in 1984, are in many cases now out of date. BAWSCA developed an alternative formula which uses a readily-available statistic (salaries of the three operating enterprises) to divide bureau costs among the Water Enterprise, the Wastewater Enterprise, and the Hetch Hetchy Water and Power Enterprise.

(iii) Water Enterprise Administrative and General: As a corollary to the change in engineering and supervision expenses and vehicle and building maintenance expenses described above (Section II, B. iv), costs of the City Distribution Division and the Water Supply and Treatment Division previously included in joint A&G are now removed. Remaining A&G expenses are primarily those associated with Water Enterprise administration.

In each of these three categories, costs that clearly provide no benefit to the wholesale customers will be identified and excluded. The remaining costs will be divided between City Retail and wholesale customers on one of two formulas. First, costs of COWCAP and Water Enterprise A&G will continue to be allocated between City and wholesale customers based on the composite O&M percentage.⁸ Second, SFPUC Bureau Costs will be divided between City retail and wholesale customers based on proportional annual usage.

Some of the changes to the treatment of O&M and A&G costs described above benefit the City; others benefit the wholesale customers. Overall, they are

⁸ Historically, this formula has assigned between 34-37% of these costs to wholesale customers. With the reduced amount of Customer Accounts costs included in the formula, the wholesale percentage will increase by about 3%-5%.

estimated to increase the wholesale customer share of these costs by approximately \$500,000 to \$1 million annually.

4. Hetch Hetchy Non-Capital Costs. Currently, Hetch Hetchy O&M expenses are identified as water-specific, power-specific, or joint. Wholesale customers pay no part of power-specific costs and less than half of the joint costs. The water-specific costs and 45% of the joint costs are allocated between City and wholesale customers on the basis of proportionate annual water use (with a minor adjustment to reflect sales of water to other customers upstream of the Bay Area). There will be no change to these principles.

Administrative and General costs are similarly classified. Water-related costs, including 45% of joint A&G, are again split between City and wholesale customers on the basis of adjusted annual proportionate use. Apart from use of COWCAP, and simplification of one allocational step, this will continue. Hetch Hetchy's share of Customer Accounts expenses has never been assigned to wholesale customers and will not be under the new Agreement.

Property taxes on Hetch Hetchy land and facilities were previously allocated among water, power and joint based on detailed analysis of asset classifications. The new Agreement will simply classify taxes as joint, with 45% allocated to water, and the wholesale customers' share based on adjusted annual water use.

These changes are expected to have a very minor impact on the amount of non-capital Hetch Hetchy costs allocable to the wholesale customers.

5. Capital Costs

(i) Existing Assets: Repayment of the wholesale customers' share of existing assets (i.e., those capitalized on or before June 30, 2009) is effectively converted from the utility method to an amortization schedule derived from the utility method, with several modifications:

- The current rate base will be replaced by a principal amount due (i.e., the wholesale share of the existing assets) excluding the "working capital" allowance, about 15% of annual O&M expenses, which is permitted by the existing Contract.
- The current depreciation will be replaced by principal repayments.
- Interest will be paid on the outstanding principal, will be fixed at 5.1%, and will be decoupled from the variable equity rate of return allowed by the California Public Utilities Commission -- currently about 10%.
- Principal and interest will be repaid in equal annual payments over the next 25 years.

On both a nominal and present discounted value basis, the payments by wholesale customers for their share of the current rate base (about \$382 million including both SFWD and Hetch Hetchy) will be less under this approach than under a continuation of the 1984 Contract methodology. The fixed return also eliminates the fluctuation in payments due to future changes in the equity rate of return allowed by the California Public Utilities Commission.⁹

(ii) New Assets: Starting with FY 2009-2010, wholesale customers will, like San Francisco retail customers, pay for capital projects on the "cash" basis.

This will mean, in practice, that wholesale customers will pay a proportionate share of (1) debt service (i.e., payment of principal and interest on SFPUC bonds and commercial paper) related to regional system assets, and will contribute a corresponding share of the SFPUC's "debt service coverage" obligation, and (2) capital projects in the regional system that SFPUC pays for out of revenues on a "pay-as-you-go" basis, rather than from borrowed funds.

In order to implement this, the new Agreement continues the existing Contract's method for distinguishing between in-City and Regional assets. But the

⁹ Revenues raised from retail customers through SFPUC appropriations prior to 2009 for revenue-funded regional projects not actually expended as of June 30, 2009 will be tracked as they are spent during the first three years of the new Agreement. That amount will then be amortized through level payments over a 10-year period, at 4% interest.

allocation of differing percentages of the costs of those assets, based on usage patterns other than annual average use, has been deleted. BAWSCA and SFPUC agreed to eliminate the division of assets into "current" and "ultimate" categories and to also eliminate the "maximum hour" and "maximum day" categories. These distinctions were insisted on by San Francisco in 1984 and have added considerable complexity to the calculation of each year's Wholesale Revenue Requirement. Dispensing with them substantially reduces the number of categories of regional system assets and will simplify administration of the new Agreement, without significantly changing the overall allocation of costs.

Debt service "coverage" is the ratio of annual net revenues (and other qualifying funds) to annual debt service payments. Revenue bond indentures typically include a covenant by the issuer to maintain a minimum Debt Service Coverage ("DSC") ratio. The higher the ratio, the more security for repayment is provided to the bondholders, which aids in achieving lower borrowing costs, which in turn benefits all system users.

The 2006 Series A Water Revenue Bonds indenture has a 1.25 minimum DSC covenant: net revenues and available fund balances must be at least 1.25 times the annual debt service payment due. The new Agreement includes a proportionate contribution to maintaining required coverage in the calculation of revenues for which wholesale customers are responsible. Wholesale payments in excess of debt service itself will be allocated to a reserve fund balance. Interest earned on the fund will be credited to wholesale customers. The Coverage Reserve is also expected to satisfy wholesale customers' share of the Water Enterprise's working capital requirements.

The wholesale customers will also contribute their share (based on annual proportional water use) towards new regional system capital projects paid for out of revenues. SFPUC considers the San Francisco Charter to require that it have funds on hand sufficient to pay for a project before it awards a construction contract. Under the cash method,

rates for both San Francisco retail customers and wholesale customers will be set based on annual appropriations fixed by the Commission in its budget, rather than on amounts subsequently expended. As with the debt service coverage issue, wholesale revenues used for revenue-funded capital projects will be transferred to a restricted reserve, interest on which will be credited to the wholesale customers. And at five year intervals, surplus accumulations in the fund (i.e., those neither spent nor formally encumbered) will be transferred to the wholesale customers' credit in the balancing account.

C. Rates and Balancing Account

1. Rates and Rate Structure. The requirements in the current Contract for the SFPUC to provide budget information, an explanation of how rates for the upcoming fiscal year have been calculated, and advance notice of Commission action on rates will all be continued. The current Contract has allowed the SFPUC considerable latitude in establishing the structure of wholesale rates -- that is, the relationship among the various components of the rate schedule (e.g., meter service charge, consumption charge, etc.). The Contract did require that the rate structure not be arbitrary, unreasonable or unjustly discriminatory as among the wholesale customers. This same approach is continued in the new Agreement. In addition, the new Agreement also provides for longer advance notice of any proposed changes in rate structure, together with an analysis of how the proposed change would affect different groups of wholesale customers and an ample opportunity for wholesale customers to comment on the proposals before they are presented to the Commission by SFPUC staff.

2. Balancing Account. The new Agreement retains the annual reconciliation between the amount due from wholesale customers (applying the formulas in the Agreement to actual costs and actual water sales) and the amount actually charged to wholesale customers. The difference will then be added to -- or subtracted from -- a "balancing account" which will earn interest and which can be taken into account in setting rates for future years. The 1984 Contract was, in retrospect, overly rigid in requiring the balancing account to be "zeroed out" as

soon as possible, which in turn led to excessive fluctuations in wholesale rates, as one correction created a need for an offsetting correction in a subsequent year. The new Agreement allows far more flexibility in dealing with the annual variances than the 1984 Contract did. For example, "positive" balances (those in favor of the wholesale customers) will in general be held as a rate stabilization account; and "negative" balances (those in favor of SFPUC) may be drawn down over three years rather than one. If a significant positive balance develops and persists for three years, wholesale customers may, through BAWSCA, direct that some or all of the credit be applied to one of several purposes, such as paying off existing assets more quickly.

D. Accounting and Auditing

The current Contract requires the SFPUC to maintain a rigorous accounting system and to carefully calculate and clearly document each year the annual Wholesale Revenue Requirement. That calculation is then audited by an independent CPA, in accordance with Generally Accepted Auditing Standards, which then issues its own "compliance audit" report. All these protections for wholesale customers will be retained. Some procedural requirements have been simplified, but a new provision has been added requiring SFPUC senior management to personally take responsibility for the SFPUC's calculation of the accuracy of the annual Wholesale Revenue Requirement.

**PART THREE
ADMINISTRATIVE PROVISIONS**

A. Term (Section 2.01)

The new Agreement will have a term of 25 years, running from July 1, 2009 to June 30, 2034. It may be extended for one, or two, additional five-year periods with the consent of the SFPUC and wholesale customers representing at least two-thirds in number and seventy-five percent (75%) of wholesale customers' water use. If a wholesale customer does not want

to remain a party to the Agreement as extended, it cannot be compelled to do so by the decision of other wholesale customers.

B. Unanimous Participation Not Necessary (Section 2.02)

The Agreement assumes that all 27 wholesale customers will sign it, as well as an individual water sales contract (with the exception of Hayward, which will continue its 1962 contract in force). However, it does not require 100% participation to become effective. So long as 21 or more wholesale customers, representing collectively 75% or more of water use in 2007-08, have signed both agreements by September 1, San Francisco may waive the requirement of unanimity, at which point the Agreement will become effective for all agencies that have signed.¹⁰

C. Amendments to Agreement (Section 2.03)

The 1984 Contract is extremely difficult to amend, requiring concurrence by a very large super-majority of wholesale customers. BAWSCA agrees with the SFPUC's suggestion that some aspects of the new Agreement should be somewhat easier to amend. However, super-majorities, in terms of both the number of agencies (two-thirds) and the percentage of water purchased (75%), continue to be required to amend basic provisions. Amendments affecting an individual agency's "fundamental rights" under the Agreement cannot be adopted without the approval of that agency.

D. Delegation of Administrative Tasks to BAWSCA (Section 8.04)

When the 1984 Contract was negotiated, there was no durable, representative organization which could be delegated responsibility to act as agent for contract administration on behalf of the wholesale customers. BAWSCA's predecessor, the Bay Area Water Users Association (BAWUA), was at that point simply an unincorporated association, governed entirely

¹⁰ The number necessary to constitute 2/3rds of the total may drop to 20 if California Water Service Company's (Cal Water) acquisition of the assets of Skyline County Water District closes before June 30, 2009, thereby reducing the total number of wholesale customers from 27 to 26.

by city and water agency staff. For that reason, the 1984 Contract provided for a variety of administrative decisions to be made by five "Suburban Representatives" -- agencies to be chosen by all BAWUA members or, absent a selection, the five largest agencies. In practice, the default option became the rule and for the past 25 years decisions about financial aspects of the contract, including the annual audit of the Wholesale Revenue Requirement, and initiation of arbitration, have been formally made by staff members of the five largest agencies, supported by BAWUA staff and consultants.

With BAWSCA's formation in 2002, wholesale customers have available a significantly better alternative to attend to a number of technical but important matters, many of which will require oversight and decisions each year. As a regional government agency, whose board of directors is comprised largely of elected officials, and with a capable professional staff, BAWSCA is both durable and well prepared to assume responsibility for many of these administrative tasks. The new Agreement takes advantage of this development by assigning the tasks previously handled by the Suburban Representatives to BAWSCA. It also enables the BAWSCA board of directors to amend several technical attachments to the Agreement, such as those describing the details of water meter maintenance/calibration, and financial reporting.

E. Annual Meeting with SFPUC Senior Management (Section 8.03)

Annual meetings of SFPUC senior management with the wholesale customers will be continued, covering topics such as water supply conditions and outlook, capital projects under construction and planned, forecasts of wholesale water purchases and rates, etc. The awkward and inaccurate name given to them in the 1984 Contract (Suburban Advisory Group, or "SAG") will be omitted. The new Agreement also establishes other avenues for communication between the SFPUC and the wholesale customers. One is the Water Quality Committee mentioned previously. Another is a commitment by the SFPUC to send representatives to the BAWSCA Technical Advisory Committee, if and when requested.

F. Dispute Resolution; Limitations on Damages (Section 8.01; Section 8.14)

The existing Contract requires that disputes related to the calculation of the Wholesale Revenue Requirement be resolved through mandatory binding arbitration. This will be continued. The length of time within which arbitration must be initiated has been shortened from 18 months after the delivery of the Compliance Auditor's report to 12 months. Disputes over other matters, such as water supply, may be presented to a court.

The Agreement limits all parties' exposure to (as well as their entitlement to) damages for breach of contract to "general damages" - those which are clearly foreseeable. There are no corresponding limits on recovery of tort damages.

G. Special Provisions for Some Agencies (Article 9 of Agreement)

Article 9 of the 1984 Contract contained provisions for 12 agencies which had one or another unique situation not shared by other wholesale agencies, but important enough to warrant inclusion in the overall Contract to insure that all parties were aware of, and consented to, these particularized arrangements. The reasons for special treatment of several agencies in 1984 (including ACWD, Coastside, and Daly City) no longer exist. However, the new Agreement continues to include individual sections applying to Brisbane/GVMID, Cal Water, Estero Municipal Improvement District, Hayward, Hillsborough, San Jose, Santa Clara and Stanford. The provisions in the sections applicable to Estero and San Jose/Santa Clara merit brief discussion.

1. Estero Municipal Improvement District. Estero's 1961 contract has a term of 50 years, rather than the typical 25 years. As a result, it will not expire until July 1, 2011. Accommodating to this, the 1984 Contract provides that Estero's individual Supply Guarantee will be based on its water purchases from SFPUC in the last calendar year of the old Contract -- i.e., 2010. Estero has proposed an alternative approach to fixing its permanent Supply Guarantee: adopting a fixed amount now, and specifying that amount in the new Agreement,

rather than waiting to see what occurs in 2010. The amount proposed is 5.9 MGD, about 0.3 MGD more than Estero's recent use. Substantial support for, and no opposition to, this proposal was voiced at a meeting of the official representatives of the wholesale customers held in mid-March. Accordingly, it is included in the new Agreement.

2. San Jose and Santa Clara. San Jose and Santa Clara have never had individual Supply Guarantees, because of their status as temporary customers. The new Agreement does not provide them Supply Guarantees. It does, however, commit SFPUC to supply them up to 9 MGD through 2018, subject to various contingencies.¹¹ The Water Supply Agreement does not allocate the 9 MGD cap between the two cities. That decision will be made solely by San Jose and Santa Clara; other wholesale customers are not involved. Once made, the decision will be incorporated in each city's individual Water Sales Contract with the SFPUC.

* * * * *

If legal counsel for any of the wholesale customers have questions about this summary report, the new Water Supply Agreement, Individual Water Sales Contracts, or the process by which (and the schedule on which) they are to be considered for approval by each wholesale customer, they should feel free to contact either of the attorneys at Hanson Bridgett whose names appear below.

Respectfully submitted,

Ray McDevitt
415-995-5010
rmcdevitt@hansonbridgett.com

Allison Schutte
415-9095-5823
aschutte@hansonbridgett.com

¹¹ This commitment does not extend beyond 2018 and does not affect the permanent Supply Guarantees of other wholesale customers.

The two following pages are copies of two attachments to the new Water Supply Agreement. They are high-level summaries, illustrating the application of the cost-allocation principles in the Water Supply Agreement to a particular year -- in this case, FY 2009-10.

The first page (Attachment N-2, Schedule 1) shows the calculation of the overall Wholesale Revenue Requirement (\$140,994,733), which includes \$28,903,512 attributable to the Hetch Hetchy Water and Power Enterprise. This schedule also shows the amount to be contributed to the Wholesale Debt Service Coverage Reserve (\$4,488,233) in FY 2009-10.

The second page (Attachment N-2, Schedule 4) provides details showing how the \$28,903,512 Hetch Hetchy component was calculated.

The dollar values and water use percentages shown in these schedules are merely estimates. The schedules are intended to be illustrative, rather than predictive. However, they may be of assistance when reading Part Two of the Summary Report, which describes the Agreement's cost-allocation principles and formulas.

WHOLESALE REVENUE REQUIREMENT SCHEDULES
CALCULATION OF WHOLESALE REVENUE REQUIREMENT
FISCAL YEAR 2009-10
REFERENCE ARTICLE 5

EXPENSE CATEGORY	CONTRACT REFERENCE	SCHEDULE REFERENCE	TOTAL	DIRECT RETAIL	DIRECT WHOLESALE	REGIONAL	JOINT EXPENSE ALLOCATION FACTOR	WHOLESALE SHARE
OPERATING AND MAINTENANCE EXPENSE:								
SOURCE OF SUPPLY	5.05 (A)	SCH B.1	\$ 14,943,953	\$ 1,251,062	\$ -	\$ 13,692,891	ANNUAL USE ¹	\$ 9,364,568
PUMPING	5.05 (B)	SCH B.1	\$ 4,342,682	\$ 3,654,000	\$ -	\$ 688,682	ANNUAL USE ¹	\$ 334,210
TREATMENT	5.05 (C)	SCH B.1	\$ 30,445,053	\$ -	\$ -	\$ 30,445,053	ANNUAL USE ¹	\$ 20,821,372
TRANSMISSION & DISTRIBUTION	5.05 (D)	SCH B.1	\$ 53,416,232	\$ 30,163,286	\$ -	\$ 23,252,946	ANNUAL USE ¹	\$ 15,902,690
CUSTOMER ACCOUNTS ²	5.05 (E)	SCH B.1	\$ 7,552,213	\$ 7,401,169	\$ 151,044	\$ -	2%	\$ 151,044
TOTAL O&M			\$ 110,700,133	\$ 42,869,517	\$ 151,044	\$ 67,879,572		\$ 46,573,883
COMPOSITE % (WHOLESALE SHARE / TOTAL O&M)	5.06 (C)							42.07%
ADMINISTRATIVE AND GENERAL EXPENSES:								
COV/CAP	5.06 (A)	SCH B.1	\$ 1,233,009	\$ -	\$ -	\$ 1,233,009	COMPOSITE O&M	\$ 520,857
SERVICES OF SFPUC BUREAUS	5.06 (B)	SCH 7	#REF!	#REF!	#REF!	#REF!	ANNUAL USE ¹	#REF!
OTHER A&G	5.06 (C)	SCH B.1	\$ 12,973,477	\$ 4,029,891	\$ -	\$ 8,943,586	COMPOSITE O&M	\$ 3,770,749
COMPLIANCE AUDIT	5.06 (D)	SCH B.1	\$ 2,000,000	\$ -	\$ -	\$ 2,000,000	50%	\$ 1,000,000
TOTAL A&G			\$ 15,206,486	\$ 4,029,891	\$ -	\$ 11,176,595		\$ 5,271,606
PROPERTY TAXES	5.07	SCH B.1	\$ 1,417,293	\$ -	\$ -	\$ 1,417,293	ANNUAL USE ¹	\$ 969,287
CAPITAL COST RECOVERY	5.08	SCH B.1	\$ -	\$ -	\$ -	\$ -		\$ -
PRE-2009 ASSETS	5.03	ATT K	\$ -	\$ -	\$ -	\$ -		\$ -
DEBT SERVICE ON NEW ASSETS	5.04 (A)	SCH 2	\$ -	\$ -	\$ -	\$ -		\$ -
REVENUE FUNDED ASSETS - APPROPRIATED TO WHOLESALE CAPITAL FUND	5.04 (B)	SCH 3	\$ -	\$ -	\$ -	\$ -		\$ -
TOTAL CAPITAL COST RECOVERY			\$ -	\$ -	\$ -	\$ -		\$ -
WHOLESALE SHARE HETCH HETCHY WATER & POWER	5.04	SCH 4	\$ -	\$ -	\$ -	\$ -		\$ -
WHOLESALE REVENUE REQUIREMENT								\$ 62,845,489
WHOLESALE REVENUE COVERAGE³								148.3%

¹Proportional Annual Use (68.39%)

²Water Enterprise Share of Customer Accounts Expenses (62% of Total Customer Accounts Expenses)

³25% of Wholesale Share of Debt Service

WHOLESALE REVENUE REQUIREMENT SCHEDULES
CALCULATION OF WHOLESAL SHARE OF HETCH HETCHY WATER & POWER
FISCAL YEAR 2009-10
REFERENCE ARTICLE 5

EXPENSE CATEGORY	CONTRACT REFERENCE	SCHEDULE REFERENCE	TOTAL	POWER SPECIFIC	WATER SPECIFIC	JOINT	JOINT ALLOCATION PERCENTAGE	WATER RELATED TOTAL	WHOLESAL ALLOCATION FACTOR	WHOLESAL SHARE
OPERATION AND MAINTENANCE										
OPERATION	5.08 B 1	SCH 8.2	\$ 44,612,220	\$ 31,853,985	\$ 9,557,861	\$ 3,200,394	45%	\$ 10,958,028	ADJUSTED PROPORTIONAL ANNUAL USE	\$ 7,484,165
MAINTENANCE	5.08 B 1	SCH 8.2	\$ 16,868,612	\$ 5,048,039	\$ 3,239,622	\$ 8,581,951	45%	\$ 3,719,100	ADJUSTED PROPORTIONAL ANNUAL USE	\$ 4,431,890
TOTAL OPERATION AND MAINTENANCE			\$ 61,480,832	\$ 36,902,024	\$ 12,796,483	\$ 11,782,345		\$ 14,677,128		\$ 12,316,055
ADMINISTRATIVE AND GENERAL										
COWCAP	5.08 B 2	SCH 8.2	\$ 1,139,579	\$ -	\$ -	\$ 139,579	45%	\$ 512,811	ADJUSTED PROPORTIONAL ANNUAL USE	\$ 348,968
SERVICES OF SFPLC BUREAUS	5.08 B 2	SCH 7	#REF!	#REF!	#REF!	#REF!	45%	#REF!	ADJUSTED PROPORTIONAL ANNUAL USE	#REF!
OTHER A&G	5.08 B 2	SCH 8.2	\$ 25,581,481	\$ 14,913,071	\$ 36,078	\$ 70,724,069	45%	\$ 4,820,623	ADJUSTED PROPORTIONAL ANNUAL USE	\$ 3,280,434
CUSTOMER ACCOUNTS	5.08 B 2	SCH 8.2	\$ 347,403	\$ 347,403	\$ -	\$ -	45%	#REF!	ADJUSTED PROPORTIONAL ANNUAL USE	#REF!
TOTAL ADMINISTRATIVE AND GENERAL			\$ 27,068,463	\$ 15,267,474	\$ 36,078	\$ 70,724,069		\$ 5,333,434		\$ 3,929,372
PROPERTY TAXES	5.08 B 3	SCH 8.2	\$ 452,000	\$ -	\$ -	\$ 456,205	45%	\$ 205,337	ADJUSTED PROPORTIONAL ANNUAL USE	\$ 139,732
CAPITAL COST RECOVERY										
PRE-2009 ASSETS	5.09 B 1	ATT K-4								\$ 3,118,003
DEBT SERVICE ON NEW ASSETS	5.09 B 2	SCH 5								#REF!
REVENUE FUNDED ASSETS-APPROPRIATIONS TO WHOLESAL CAPITAL FUND	5.09 B 3	SCH 6								#REF!
TOTAL CAPITAL COST RECOVERY										#REF!
WHOLESAL SHARE OF HETCH HETCHY WATER & POWER										(TO SCHEDULE 1)
WHOLESAL REVENUE COVERAGE ¹										#REF!

¹Adjusted Proportional Annual Use (68.39% X 99.50% + 68.05%)
²25% of Wholesale Share of Debt Service

NOTICE OF DETERMINATION

To: State of California
Office of Planning and Research
PO Box 3044 (mailing address)
1400 Tenth Street (street address)
Sacramento, CA 95812-3044

County Clerk, Alameda County
Alameda County Clerk—Recorder's Office
1106 Madison Street
Oakland, CA 94607

From: City of Hayward

Approval Date: July 28, 2009

Project Title: Water Supply Agreement between the City and County of Francisco
- and Wholesale Customers in Alameda County, San Mateo County
and Santa Clara County

Project Location: Alameda, San Francisco, San Mateo and Santa Clara Counties

Lead Agency: City and County of San Francisco Planning Department

Responsible Agency: City of Hayward

Contact Person: Alex Ameri
Deputy Director of Public Works
(510) 583-4720

Pursuant to the California Environmental Quality Act (CEQA), the Guidelines of the Secretary for Resources, this Notice of Determination is transmitted to you for filing. At the end of the posting period, please return this Notice to the Staff Contact with a notation of the period it was posted.

I. PROJECT DESCRIPTION:

City of Hayward ("Agency") approved the Water Supply Agreement ("Agreement") by its Resolution No. ____ on _____, 2009. The San Francisco Public Utilities Commission (SFPUC) approved the Agreement by its Resolution No. 09-0069 on April 28, 2009. The Agreement sets forth the terms by which the SFPUC will provide, and the wholesale water customers will purchase, water from the San Francisco Regional Water system for a term of 25-years.

The Agreement is in furtherance of, and implements in part, the Regional Water System Improvement Program ("WSIP") that was approved on October 30, 2008 by SFPUC Resolution No. 08-0200. Agency approved the Agreement in reliance on the Final Program Environmental Impact Report for the WSIP, State Clearinghouse No. 2005092026 ("Final PEIR"). The Agency found that since the Final PEIR was finalized, there have been no substantial project changes and no substantial changes in project circumstances that would require major revisions to the Final PEIR due to the involvement of new significant environmental effects or an increase in the severity of previously identified significant impacts, and there is no new information of substantial importance that would change the conclusions set forth in the Final PEIR.

II. DETERMINATION:

The Agency approved the Agreement on July 21, 2009 (Agency Resolution No. _____).

1. A Final Program Environmental Impact Report has been prepared for the WSIP by the City and County of San Francisco and certified pursuant to the provisions of CEQA (San Francisco Planning Commission Motion No. 17734) and approval of the Water Supply Agreement is within the scope of the WSIP and activities evaluated in the Final PEIR
2. A determination has been made that the entire WSIP project in its approved form will have a significant effect on the environment.
3. San Francisco adopted mitigation measures as a condition of project approval and has authority to implement the measures and the Agency has no direct authority to implement the mitigation measures (SFPUC Resolution No. 08-0200 and No. 09-0069).
4. Findings were made, including the Statement of Overriding Considerations, and the Mitigation and Monitoring and Reporting Program were adopted for this project (SFPUC Resolution No. 08-0200 and No. 09-0069).

This is to certify that the Water Supply Agreement and Record of Approval are available to the general public at:

777 B Street
Hayward, CA 94545

Date: _____

By: _____

Name: Alex Ameri
Title: Deputy Director of Public Works

Date received for filing: _____

Attached fee

___ \$50 filing fee, Alameda County

DRAFT

NH
7/7/09

HAYWARD CITY COUNCIL

RESOLUTION NO. 09-_____

Introduced by Council Member _____

RESOLUTION APPROVING WATER SUPPLY AGREEMENT
WITH THE CITY AND COUNTY OF SAN FRANCISCO

WHEREAS, the City of Hayward (City) has purchased water from the City and County of San Francisco (San Francisco) for many years; and

WHEREAS, the "Settlement Agreement and Master Water Sales Contract" between the City and San Francisco, which was entered into in 1984, expired on June 30, 2009; and

WHEREAS, the City is a member of the Bay Area Water Supply and Conservation Agency (BAWSCA), which was formed in 2002 pursuant to Water Code Section 81300 *et seq.* to represent the interests of the communities in Alameda, San Mateo and Santa Clara counties that purchase water from San Francisco; and

WHEREAS, on October 24, 2006, this Council, by Resolution No. 06-128 appointed BAWSCA to represent it in negotiations for a new water supply agreement with San Francisco; and

WHEREAS, each of the other 26 entities which are members of BAWSCA similarly delegated negotiating authority to BAWSCA; and

WHEREAS, BAWSCA has submitted periodic reports to City on progress during the negotiations and has provided detailed briefings on all significant elements of the Agreement; and

WHEREAS, a Water Supply Agreement, in the form negotiated by BAWSCA, was presented to and approved by the San Francisco Public Utilities Commission on April 28, 2009; and

WHEREAS, the Water Supply Agreement incorporates provisions which accomplish the majority of the goals which the City sought to achieve in a new long-term contractual relationship with San Francisco; and

WHEREAS, the City Manager has so recommended.

NOW, THEREFORE, BE IT RESOLVED:

1. The "Water Supply Agreement Between the City and County of San Francisco and Wholesale Customers in Alameda County, San Mateo County, and Santa Clara County" dated July 2009 (Agreement) is approved.

2. The City Manager is authorized and directed to sign the Agreement, in the form previously approved by the San Francisco Public Utilities Commission, on behalf of the City.

IN COUNCIL, HAYWARD, CALIFORNIA _____, 2009

ADOPTED BY THE FOLLOWING VOTE:

AYES:

NOES:

ABSTAIN:

ABSENT:

ATTEST: _____
City Clerk of the City of Hayward

APPROVED AS TO FORM:

City Attorney of the City of Hayward

DRAFT

NH
7/7/09

HAYWARD CITY COUNCIL

RESOLUTION NO. 09-_____

Introduced by Council Member _____

ADOPTING FINDINGS FOR PURPOSES OF
THE CALIFORNIA ENVIRONMENTAL QUALITY ACT
IN CONNECTION WITH APPROVAL OF A WATER
SUPPLY AGREEMENT WITH THE CITY AND COUNTY
OF SAN FRANCISCO

WHEREAS, the City of Hayward (City) purchases water from the City and County of San Francisco (San Francisco) pursuant to a Settlement Agreement and Master Water Sale Contract entered into in 1984, which expired on June 30, 2009; and

WHEREAS, the San Francisco Public Utilities Commission (SFPUC or Commission) operates the Regional Water System which delivers water to communities in Alameda, San Mateo and Santa Clara Counties, as well as to customers within San Francisco; and

WHEREAS, engineering reports prepared by and for the SFPUC staff identified serious deficiencies in the Regional Water System which exposed its Bay Area customers to the threat of an extended interruption in water delivery in the event of a major earthquake; and

WHEREAS, acting in response to directions from the State Legislature (California Water Code Section 73500 *et seq.*), in 2002 the SFPUC adopted a Water System Improvement Program (WSIP) to address these deficiencies, ensure the Regional Water System's ability to deliver water meeting Safe Drinking Water Act standards, and otherwise improve the Regional Water System's capabilities of meeting customer needs; and

WHEREAS, the San Francisco Planning Department prepared a Program Environmental Impact Report (PEIR) to evaluate the potential environmental impacts of implementing the WSIP and the Bay Area Water Supply and Conservation Agency (BAWSCA), of which City is a member, reviewed and commented on the draft PEIR; and

WHEREAS, the San Francisco Public Utilities Commission certified the Final PEIR on October 30, 2008 in its Motion No. 17743, which motion is on file with City; and

WHEREAS, on October 30, 2008, the SFPUC reviewed and considered the PEIR prepared for the WSIP, adopted findings required by the California Environmental Quality Act (CEQA), including a mitigation monitoring and reporting program and a statement of overriding

considerations, and approved the WSIP in its Resolution No. 08-0200, which resolution is on file with City; and

WHEREAS, on October 30, 2008, the SFPUC also endorsed selected Water Supply Elements for the new Water Supply Agreement, which are consistent with the WSIP evaluated in the Final PEIR, in its Resolution No. 08-0201, which resolution is on file with City; and

WHEREAS, the SFPUC, on April 28, 2009, approved a Water Supply Agreement with its wholesale customers, including City, and recommended that they likewise approve it; and

WHEREAS, prior to acting on the Water Supply Agreement and the accompanying individual Water Sales Contract, the City Council desires to make certain findings pursuant to 14 California Code of Regulations Section 15096.

NOW, THEREFORE, BE IT RESOLVED that the City Council finds as follows:

1. City has reviewed the information contained in the Final PEIR that is relevant to its approval of the Water Supply Agreement and has reviewed the CEQA findings contained in SFPUC Resolution No. 08-0200, including the Statement of Overriding Considerations and the Mitigation Monitoring and Reporting Program, which are adopted to the extent they are relevant to the City's decision to approve the Water Supply Agreement.
2. The SFPUC has already adopted the mitigation measures recommended in the PEIR, has authority to implement the mitigation measures or to seek any required approvals for the mitigation measures, and City has no direct authority to implement the mitigation measures, which may be funded in part with revenues from the Water Supply Agreement.
3. City has reviewed and considered the Final PEIR and finds that the Final PEIR is adequate for its use as the decision-making body for its consideration of the Water Supply Agreement.
4. Approval of the Water Supply Agreement is within the scope of the WSIP and activities evaluated in the Final PEIR.
5. Since the Final PEIR was finalized, there have been no substantial project changes and no substantial changes in project circumstances that would require major revisions to the Final PEIR due to the involvement of new significant environmental effects or an increase in the severity of previously identified significant impacts, and there is no new information of substantial importance that would change the conclusions set forth in the Final PEIR.
6. City has not identified any feasible alternative or additional feasible mitigation measures within its powers that would substantially lessen or avoid any significant effect the WSIP would have on the environment; and

BE IT FURTHER RESOLVED that the City Manager prepare and file a Notice of Determination with the County Clerk promptly upon the Council's approving the Water Supply Agreement with San Francisco.

IN COUNCIL, HAYWARD, CALIFORNIA _____, 2009

ADOPTED BY THE FOLLOWING VOTE:

AYES:

NOES:

ABSTAIN:

ABSENT:

ATTEST: _____
City Clerk of the City of Hayward

APPROVED AS TO FORM:

City Attorney of the City of Hayward