

Resolution W-4655
Apple Valley/AL 140-W/FLC/JPT/EYC/AJT/ijj

August 23, 2007

APPENDIX B

MEMORANDUM OF UNDERSTANDING

This Memorandum of Understanding (MOU) is entered into between Apple Valley Ranchos Water Company (AVR) and the Division of Ratepayer Advocates (DRA), collectively, the Parties.

1. Recitals

A. AVR's current rates were set in Decision 05-12-020 issued by the California Public Utilities Commission in December of 2005 for test Year 2006 and Escalation Years 2007 and 2008.

B. Since 2003, AVR has been requiring applicants for a main extension to advance the cost of the acquisition of one acre foot of Base Annual Production water rights per residential lot as special facilities under its Main Extension Rule. AVR has informed DRA that it began having difficulty acquiring water rights with the result that, in some cases, by the time water rights could be found available for purchase, the cost had increased over the then, current market price advanced by applicants, and eventually the difficulty reached a point where AVR was unable to find any water rights available for purchase. AVR currently has approximately \$1.5 million of moneys advanced from applicants for main extensions for the purpose of acquiring water rights and for which AVR has not been able to find water rights available to purchase. Although water rights are not readily available for purchase, the Mojave Water Agency (MWA) has a program under which Replacement Water can be pre-purchased for future years, "banked" in the groundwater basin, and pumped in the future years. This MOU deals with the resolution of this situation.

2. Agreements and Understandings

A. AVR agrees to file an advice letter to modify its Main Extension Rule (Rule 15) to incorporate a Supplemental Water Acquisition Fee, to be charged to applicants for main extensions as a refundable advance, similar to AVR's existing Supply Facilities Fee adopted in Decision 05-12-020, in order to address issues of long-term availability and cost of water supply. The Supplemental Water Acquisition Fee requested by AVR will be set at \$3,000 per residential lot for Residential developments and for Commercial, Industrial or other types of developments, will be set at a rate of \$3,000 per equivalent

average residential water use based on the water use of a similar business or facility. The stated purpose of the Supplemental Water Acquisition Fee will be to fund AVR's pre-purchase of Replacement Water from MWA, or for AVR to acquire water rights should they become readily available. Pre-purchased Replacement Water purchased from MWA will be capitalized by AVR and amortized to expense over a 40-year period consistent with the life of the advance contract set forth in the Main Extension Rule. AVR proposes to file the advice letter within approximately 30 days from the date of this MOU.

B. The Parties agree to support AVR's advice letter filing described above. The Parties also agree that the fee described above is appropriate through December 31, 2008. Either Party may propose changes to the existence, amount, nature, or purpose of the fees in AVR's next ORC proceeding, or subsequent proceedings, to be effective January 1, 2009 or later. Either Party is free to oppose any such proposed changes.

C. The Parties agree that, until the above referenced Supplemental Water Acquisition Fee becomes effective, AVR will continue to collect from applicants for main extension, as a refundable advance, the current market cost, as best it can be determined, of one acre-foot of water rights per residential lot. The Parties agree that these moneys, along with all other moneys collected to purchase water rights for which AVR has not expended because of its inability to find water rights available to purchase, shall be used to pre-purchase Replacement Water from MWA or to purchase water rights from the Mojave Basin should any become readily available at the time.

D. As of this date, AVR has in its possession approximately \$1.5 million of unspent moneys which were collected from applicants for main extensions for the purchase of water rights. The Parties agree that the moneys collected by AVR so far and any additional collected through December 31, 2008, either for the purchase of water rights at their current market price or as Supplemental Water Acquisition Fees pursuant to the modification of AVR's Main Extension Rule once it becomes effective, will be considered by the Parties for all purposes to be the correct amounts, appropriately advanced, to have been collected from applicants for the acquisition of supplemental water. The parties agree that the amount of water rights and/or pre-purchased Replacement Water purchased by AVR with the moneys collected as described above through December 31, 2008 will be considered to be the correct amount to have been


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acquired. The Parties agree that the amounts of moneys advanced and the amounts of water rights and/or pre-purchased Replacement Water purchased by AVR with the moneys collected as described above through December 31, 2008 will be used as the basis for setting rates to be effective from January 1, 2009 onward. The Parties agree that either party in the next general rate increase proceeding may propose a different manner of collection, on a prospective basis, from January 1, 2009 onward, and either party may propose some other ratemaking treatment for moneys collected on or after January 1, 2009.

E. The Parties agree that the procedures described above with respect to the amounts of moneys advanced and the amounts of water rights and/or pre-purchased Replacement Water purchased by AVR with the moneys collected through December 31, 2008 will be reflected in AVR's next GRC along with any consequent and consistent impact on rate base and expenses. The Parties agree not to seek changes in AVR's rates to reflect the changed procedures described in this MOU that would be effective prior to January 1, 2009.

F. The Parties agree that no signatory to the MOU assumes personal liability as a result of this agreement. All rights and remedies of the Parties are limited to those available before the Commission.

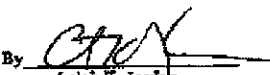
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Dated: October 23, 2006

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