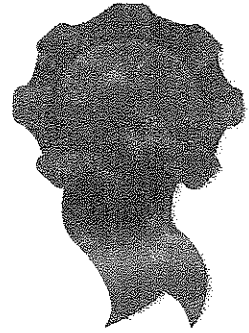


The Town of Apple Valley Blue Ribbon Water Committee



January 9, 2012

Re: Submittal of Blue Ribbon Water Committee's Final Report

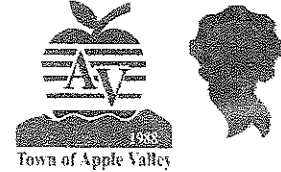
Attention: John Brown, Esq. and Charity Schiller, Esq., Best, Best & Krieger, LLC

The Blue Ribbon Water Committee (BRWC) is pleased to submit its Final Report. As you know, the Town Council appointed to the BRWC 15 citizens with a variety of water, public works, engineering, accounting, public agency experience, and other areas of expertise to obtain the BRWC's recommendations regarding critical water issues facing the Town. This letter summarizes the BRWC's recommendations and ultimately provides to the Town Council the BRWC's Final Report.

The 14 BRWC members and I are transmitting seven (five Council in white plus two in blue notebooks) originals of the report entitled, "Blue Ribbon Water Committee Final Report: Town of Apple Valley's Best Opportunity for Affordable Water and Economic Sustainability". The BRWC Final Report was completed as expeditiously as possible, subsequent to numerous CPUC decisions and other previous issues brought up by Town Councilmembers and the Town's Attorney. After eight months of hard work, the review of thousands of pages of documentation, and the completion of countless hours of research and report writing, the BRWC's Final Report provides the detailed background information and written recommendations for Council's ultimate review and action, as you deem appropriate.

The BRWC focused on evaluating three difficult issues facing the Town and its ratepayers and making recommendations:

1. The proposed Carlyle Group's acquisition of Park Water Company, including the Apple Valley Ranchos Water Company (AVR), which currently provides water service to the majority of the Town's residents California Public Utilities Commission Proceeding No. 11-01-001); and
2. The Proposed Increase in Rates by over 25% sought by the Apple Valley Ranchos Water Company (California Public Utilities Commission Proceeding No. 11-01-001); and
3. The potential feasibility of the Town's acquisition of one or more of the privately owned water companies presently selling water to the ratepayers of the Town of Apple Valley.

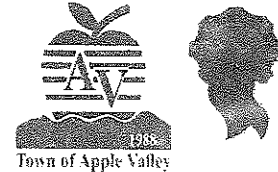


1. RECOMMENDATIONS regarding the Carlyle acquisition of Park Water Company:

- Due to urgency, on October 20, 2011, the BRWC recommended that the CPUC place seven stipulations on the acquisition of Apple Valley Ranchos Water Company, because it appears that the Carlyle Group, with permission from the CPUC, plans continually to increase the ultimate financial burden laid on the Town's water ratepayers. Both the Carlyle Group and Apple Valley Ranchos Water Company fiercely opposed the proposed stipulations. The CPUC's Administrative Law Judge Long summarily dismissed the request for stipulations.
- On Nov. 1, 2011, Administrative Law Judge Long conditionally approved the Carlyle Merger. On Nov. 21, 2011, the Town submitted revised BRWC recommended stipulations as part of the Town's opposition to the CPUC recommendation for the Carlyle merger. However, on December 1, 2011, the CPUC approved the Carlyle Merger.
- **The BRWC recommends renewing the submittal of the proposed or similar stipulations to the extent any other opportunities to do so become available.**

2. RECOMMENDATIONS regarding proposed water rate increases:

- Despite fierce opposition by AVR's ratepayers and the Town's legal counsel, on Dec. 1, 2011, Administrative Law Judge Long conditionally approved additional rate increases by AVR. Moreover, in December of 2011, AVR requested two Interim Rate Increases until the CPUC could decide whether allowing AVR to hike water rates only 11.44%, as the CPUC Division of Ratepayer Advocates recommends, or 14.7% as AVR wants. The Town's Counsel will advise whether these Interim Rate Increases will be in addition to the ultimate CPUC-decided rate increase.
- **The BRWC recommends continuing to oppose excessive rate increases by the Apple Valley Ranchos Water Company and Golden State Water Company, both now and in the future.**
- **The BRWC recommends that a Town representative provide written opposition and attend any further public meetings or hearings held by the CPUC to oppose continual rate increases by the Carlyle Group. Attendance is imperative at such meetings to expose publicly the egregious abuse perpetrated on the water ratepayers of Apple Valley.**



3. RECOMMENDATIONS regarding the feasibility of the Town's acquisition of privately held water companies:

- At this time, the Town should NOT purchase any water companies presently serving the Town of Apple Valley. Based upon the BRWC's investigation and financial analysis, currently a Town-owned water company is not financially feasible, because most methods of financing will require substantial increases in water costs and/or taxes. Moreover, most financing methods require voter approval, which is unlikely in the current depressed economy. For more information, see the financial Executive Summary submitted with this letter.
- Eminent domain acquisition of Apple Valley Ranchos or Golden State Water Company is not justified, because the price cannot be determined without costly litigation, and it could exceed \$100 million solely for AVR.
- Future economic circumstances may change and make a Town-owned water utility feasible. Therefore, the Town Council should continue to be prepared to purchase the privately held water companies if the right set of circumstances and financing arises.

The BRWC makes additional recommendations for the Council's consideration and approval:

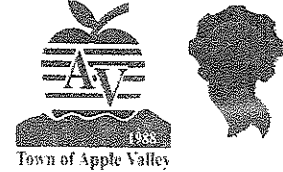
4. ADDITIONAL RECOMMENDATION: The Town use eminent domain or other legal processes to acquire permanent water rights for all citizens of Apple Valley.

The BRWC strongly recommends that the Town immediately create the legal mechanism and requirements for any new development to provide the correct (Nexus Study) amount of "Water Rights". Also for these "Water Rights" to be transferred to the Town for "Permanent Ownership" in exchange for any jurisdictional approvals required for the specific purposes of reducing the current financial impact to the existing AVR ratepayers (i.e., the Town would require 0.80 acre-feet of Water Rights per residential unit or equivalent for commercial and industrial uses).

Since 1997, more than 8,000-acre feet of water rights, adjudicated on Apple Valley land, have been sold to the cities of Adelanto, Hesperia, and Victorville, and to out-of-state speculators (e.g., Aqua Capital Management). As a result, these traded water rights are no longer available to the Town and are commodities on the for-profit water market.

The Council needs to implement a plan immediately that keeps Apple Valley's historical water rights in the Town and its sphere of influence.

5. ADDITIONAL RECOMMENDATION: The Town evaluate the feasibility of creating a proposed separate entity (i.e., Apple Valley Water Authority) to specifically integrate numerous legally mandated Master Plans, such as Stormwater, Sewer, Salt-Nutrient and other County and Mojave Water Agency planning efforts.



The following are a few of the foundational conclusions BRWC members agree to in principle:

- BRWC believes the citizens and the Town of Apple Valley should own our natural resources, specifically water and associated water systems.
- BRWC recommends the formation of a citizens' committee for continuous monitoring of both Apple Valley Ranchos and Golden State Water Company's water operations and all their dealing and approvals with the CPUC—not just their requests for rate increases.
- Generally, the BRWC supports a “true” free enterprise system. However, a CPUC-regulated, for-profit water company monopoly is not a true free enterprise, because it has a built-in rate of return for investors that can exceed 10%.
- The CPUC review and approval system does not require CPA-audited, Generally Accepted Accounting Principals (GAAP), or typical public company accounting information for public review. Thereby, the BRWC believes we have not received all of the “true numbers” of the Apple Valley Ranchos Water Company and that it has been averaging 15.7% pre-tax profits, while insisting it is “not guaranteed” a profit.
- Furthermore, the BRWC does not believe that Golden State Water Company, Apple Valley Ranchos, nor the Carlyle Group have the tax paying citizens of the Town of Apple Valley and, specifically, the ratepayers' “best interest at heart”.
- The BRWC is particularly concerned about the Town of Apple Valley's ability to attract future businesses and industry around the Apple Valley Airport and Interstate 15 corridor because of crippling and non-competitive local water rates.

In conclusion, the BRWC hopes that these recommendations and conclusions are of assistance to the Town Council in deciding how best to proceed.

On a personal note, I and the other BRWC members are pleased to have played a part in the Town's evaluation of how best to provide long-term protection of the Town's water uses and ratepayers.

Sincerely,

A handwritten signature in black ink, appearing to read 'Carl Coleman', written over a horizontal line.

Carl Coleman, PE

Blue Ribbon Water Committee Chairman

Enclosure: ***Blue Ribbon Water Committee Final Report***



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CONFIDENTIAL
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January 25, 2012

VIA MESSENGER

Honorable Town Mayor and Council Members
Town of Apple Valley
14955 Dale Evans Parkway
Apple Valley, Ca 92307

Re: Apple Valley Ranchos Water Company - Merger and Rate Increase
Matters - Blue Ribbon Water Committee

Honorable Town Mayor and Council Members:

Pursuant to your direction at last night's Town Council Meeting, enclosed please find your 3-ringed binder containing your copy of the Blue Ribbon Water Committee Report. As discussed, we are prepared to disclose this document and one other as part of the Town's response to recent Public Records Act requests from Apple Valley Ranchos Water Company counsel. However, I would like to first give you the opportunity to review the Report and invite you to personally contact me with any questions or concerns you may have. Barring any unresolved questions or comments from you, we intend to disclose the requested Blue Ribbon Water Committee Report and related "Final Report" document to the requesting parties on Wednesday, February 1, 2012.

Please review the enclosed documentation and contact me directly by phone at (909) 483-6640 with any questions or concerns you may have. Thank you.

Sincerely,

John E. Brown
of BEST BEST & KRIEGER LLP
Town Attorney
Town of Apple Valley

Cc: Frank Robinson, Town Manager