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February 4, 2008

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STATE WATER RESOURCES CONTROL BOARD
108 FEB - 4 PM 3:17
DIVISION OF WATER RIGHTS
SACRAMENTO

Re: *Response to Notice of Draft Cease and Desist Order Regarding Diversion of Water from the Carmel River*

Dear Mr. Kassel:

California-American Water Company ("CAW") received the January 15, 2008 Notice of Draft Cease and Desist Order Regarding the Continued Unauthorized Diversion of Water from the Carmel River in Monterey County ("Draft CDO"). Diepenbrock Harrison will be assisting CAW in its defense of the Draft CDO.

CAW is a privately owned Class A water service and wastewater utility company regulated by the California Public Utilities Commission ("CPUC"). CAW collects, treats, and distributes water for public and private use and consumption. CAW provides municipal water service to most of the Monterey Peninsula, including the cities of Carmel, Del Rey Oaks, Monterey, Pacific Grove, Sand City and Seaside. In addition, CAW services the unincorporated areas of the Carmel Valley and the Highway 68 corridor. CAW has approximately 38,000 metered customers. Without sufficient water supplies, the health and safety of CAW's customers will be jeopardized - a fact recognized by the State Water Resource Control Board ("State Water Board").

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James W. Kassel
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State Water Resources Control Board
February 4, 2008
Page 2

In its Draft CDO, the State Water Board staff alleges that CAW has not complied with Condition No. 2 of State Water Board Order 95-10. Condition No. 2 of Order 95-10 requires CAW to pursue one or more of three courses of action to obtain supplemental water supplies. The courses of action set forth in Condition No. 2 include: (1) obtaining appropriative permits for water CWA is currently diverting from the Carmel River; (2) obtaining water from other sources of supply and making one-for-one reductions in unlawful diversions from the Carmel River [excluding production from the Seaside groundwater basin] and/or; (3) contracting with another agency having appropriative rights to divert and use water from the Carmel River. (Order 95-10, p. 40). CAW has taken diligent steps to pursue each of these courses of action.¹ It is beyond reasonable dispute that CAW is meeting the terms and conditions of Order 95-10. The Draft CDO fails to present evidence that warrants a different conclusion.

In addition, the Draft CDO proposes a schedule for "compliance." The schedule conflicts with the mandates of the California Public Utilities Code and actions required to protect health and safety. The schedule would likely place CAW in a no win position. It would force CAW to decide if it will comply with CDO, but violate the California Public Utilities Code and jeopardize the health and safety of its approximately 38,000 metered customers. Again, the Draft CDO also fails to present evidence to support its unworkable, proposed schedule.

Accordingly, if the State Water Board staff maintains its effort to impose the Draft CDO, CAW respectfully requests, pursuant to California Water Code section 1834, that the State Water Board schedule a hearing on the matter.

During a hearing, CAW will demonstrate that the allegations presented in the Draft CDO are unwarranted and that the Draft CDO is unsupported by sufficient evidence. The following describes some of the activities undertaken by CAW, in furtherance of the conditions set forth in Order 95-10. It also explains why the schedule proposed in the Draft CDO cannot be imposed.

¹ CAW has also undertaken a number of additional actions to minimize its impact on public trust resources. For example, CAW has entered into annual Memoranda of Understanding with the California Department of Fish and Game and MPWMD to have quarterly meetings regarding a water budget that guides the withdrawal of water in light of current Carmel River conditions.

DIEPENBROCK HARRISON

James W. Kassel
Assistant Deputy Director for Water Rights
State Water Resources Control Board
February 4, 2008
Page 3

CAW is Pursuing Appropriative Permits for Carmel River Water Rights

CAW is a joint water rights owner to the Phase I Aquifer Storage and Recovery Project ("ASR"). As the State Water Board and its staff are well aware, the ASR is an effort by CAW and the Monterey Peninsula Water Management District ("MPWMD") to capture water extracted by CAW's Carmel River wells during high river flows and direct that water through a new pipeline to MPWMD injection wells within the Seaside groundwater basin. In addition to recharging the basin, this water would be accounted as a separate, stored source of water that could be extracted during periods of low river flows. Consequently, pumping of Carmel River water would be reduced during low-flow periods.

The State Water Board issued water right Permit 20808A for the ASR, which allows diversion of up to 2,426 acre-feet from the Carmel River when flows exceed those necessary to protect endangered steelhead. CAW and MPWMD are completing the process of obtaining a streambed alteration agreement and waste discharge requirements for this Project. These rights are appropriative rights to Carmel River Water.

CAW has also renewed its efforts to perfect rights to 2,984 acre-feet per year of Carmel River water pursuant to the rights recognized in table 13 of Decision 1632. CAW was informed on December 13, 2007 that, because the State Water Board has already determined that water for those rights is available, CAW could possibly perfect those rights without the extensive analysis required for other appropriative rights. CAW is committed to providing the State Water Board, Division of Water Rights with an amended application and appropriate California Environmental Quality Act documentation by March 31, 2008.

CAW has filed applications with the State Water Board for appropriative rights to Carmel River water for the Carmel River Dam. CAW is a regulated utility, California Public Utilities Code section 1001 requires CAW to obtain a Certificate of Public Convenience and Necessity ("CPCN") from the CPUC before constructing or extending any line, plant, or system. CAW submitted water rights and CPCN applications for the Carmel River Dam; however, Assembly Bill ("AB") 1142 (1998) required the CPUC to study all available alternatives to a dam on the Carmel River and identified desalinization as a potential solution to long-term Monterey Peninsula water supply deficiencies. Thus, at this time, CAW does not have the legal authority to move forward with those appropriative rights.

DIEPENBROCK HARRISON

James W. Kassel
Assistant Deputy Director for Water Rights
State Water Resources Control Board
February 4, 2008
Page 4

CAW is Pursuing Additional Sources of Water Supply

As noted previously, one compliance option for Condition No. 2 is to obtain water from alternative sources of water and reduce pumping from the Carmel River on a one-for-one basis. The CPUC's AB 1142 Report (2002),² also known as the "Plan B" report, identifies desalinization as a potential solution to long-term Monterey Peninsula water supply deficiencies. The Coastal Water Project proposes a 10,370 acre-foot desalinization operation and a conveyance system to move water from the desalinization facility to CAW's existing distribution system. CAW submitted the desalinization proposal to the CPUC for review. The CPUC determined that before it could consider approval of the Project, it needed to prepare an environmental impact report. To that end, the CPUC has hired an outside consultant, which is undertaking that effort. The CPUC expects to release a draft environmental impact report for public review in 2008.

CAW has also secured temporary supplies of additional water through an operating lease for the City of Sand City's desalination plant. This operating lease will provide CAW annually with 300 acre-feet of water once it begins operation in 2009. That additional supply will slowly diminish over the next 20 years as additional water is demanded by new uses within the City of Sand City, but will provide some immediate relief to demand from the Carmel River.

Finally, the Seaside Watermaster is investigating a recycled water project that would artificially replenish the Seaside groundwater basin. CAW hold two votes on the Watermaster Board and pays over 80% of the costs incurred by the Watermaster. Subject to Court approval, this would make additional water available from the Seaside Basin that CAW could use in lieu of Carmel River water.

CAW is Entering into Contracts with Water Rights Holders

The third listed compliance option in Condition No. 2 is for CAW to enter into contracts with appropriative right holders. As the State Water Board staff is well aware, the vast majority of the appropriative rights to the Carmel River were granted to MPWMD in Decision 1632. CAW entered into a contract with MPWMD to become a joint owner of the ASR, and has agreements with MPWMD to formalize joint ownership of additional water rights.

² AB 1142, which commissioned the Report, was passed by the Legislature in 1998.

DIEPENBROCK HARRISON

James W. Kassel
Assistant Deputy Director for Water Rights
State Water Resources Control Board
February 4, 2008
Page 5

The Proposed Remedy in the Draft CDO Conflicts with the Public Utilities Code and Order 95-10

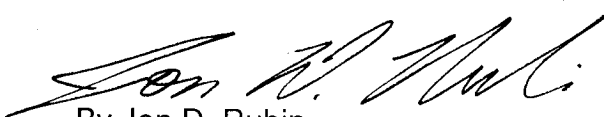
The Draft CDO proposes a schedule that would require CAW to reduce its appropriation of water from the Carmel River, as a remedy to the alleged violation of Condition No. 2. The schedule in the Draft CDO is not drafted in a manner that is consistent with the law. The schedule conflicts with the mandates of the California Public Utilities Code, which require CAW, as a regulated utility, to provide service to all customers within its service area. It also conflicts with Order 95-10, in which the State Water Board found that "[t]he people and the businesses on the Monterey Peninsula must continue to be served water from the Carmel River in order to protect public health and safety." (Order 95-10, p. 37). Finally, like other sections of the Draft CDO, the schedule presented in the Draft CDO is not supported by sufficient evidence.

Conclusion

In sum, the information outlined in this letter, as well as additional information CAW will be prepared to submit as evidence at the hearing, clearly demonstrate that issuance of a cease and desist order against CAW cannot be supported by sufficient evidence. CAW is in compliance with Order 95-10. It has been diligently pursuing a variety of measures in an effort to obtain necessary, supplemental water, in addition to measures to minimize its effects on public trust resources. Further, the schedule presented in the Draft CDO is contrary to law and unsupported by sufficient evidence. For all of these reasons, CAW objects to the Draft CDO. If the State Water Board staff continues to pursue the Draft CDO, CAW requests, pursuant to the procedure established under California Water Code section 1834, a hearing before the State Water Board.

Very truly yours,

DIEPENBROCK HARRISON
A Professional Corporation



By Jon D. Rubin
Attorneys for California-American Water Company

cc: B. Kent Turner
Carrie Gleeson, Esq.
Tim Miller, Esq.