

**EXHIBIT 2-A**

**MEMORANDUM**

TO: David J. Stoldt, General Manager  
FROM: Sidley Austin LLP  
RE: Cal-Am Ratepayer Relief Bonds (Securitization)  
DATE: March 29, 2013

---

**Districts' Securitization Proposal.**

The Monterey Peninsula Water Management District (the "District") is proposing a tax-exempt securitization, through the issuance of Ratepayer Relief Bonds, to provide a portion of the funds necessary to build Cal-Am's desalination facility. To date, approximately \$8 billion of similar securitizations for other purposes have been authorized by the California legislature and approved by the California Public Utilities Commission ("CPUC"). These securitization transactions are listed on Appendix A.<sup>1</sup> Each securitization was approved for the purpose of recovering utility costs at a substantially lower cost to ratepayers than traditional utility cost recovery mechanisms. The purpose of the securitization proposed by the District is to achieve the same result, a substantial cost savings to ratepayers as compared to Cal-Am's traditional cost recovery mechanism.

Each of the prior California securitizations secured AAA ratings from the major rating agencies. The District is having discussions with the rating agencies with the objective of obtaining similar ratings for the proposed securitization.

While utility securitizations to date (including the California securitizations) have involved electric utilities, the securitization mechanism is equally applicable to a regulated water utility, such as Cal-Am. Further, the use of securitization has been applied to finance construction costs, such as desalination plant construction costs to be incurred by Cal Am. West Virginia authorized and implemented securitizations for the purpose of financing the costs of a pollution control facility.<sup>2</sup> The rating agencies have begun to view securitization as a mechanism for funding

---

<sup>1</sup> Nationwide, utility securitizations have aggregated over \$47 billion. See Appendix B.

<sup>2</sup> See (i) Form S-1 filed by MP ENVIRONMENTAL FUNDING LLC, As filed with the Securities and Exchange Commission on March 19, 2007 - REGISTRATION NO. 333-139820; (ii) Form S-1 filed by MP ENVIRONMENTAL FUNDING LLC, As filed with the Securities and Exchange Commission on December 15, 2009 - REGISTRATION NO. 333-162749; (iii) Form S-1 filed by PE ENVIRONMENTAL FUNDING LLC, As filed with the Securities and Exchange Commission on March 19, 2007 - REGISTRATION NO. 333-139937; and

long-lived utility assets. For example Moody's has stated "[s]ecuritization could also be used to help fund the next generation of nuclear plants to be built in the U.S."<sup>3</sup> While many previous utility securitizations generally have a short average life (with scheduled maturities often of ten years or less), the West Virginia securitizations had a 20-year scheduled term, to reflect the life of the pollution control facilities being financed. There is no legal reason why a securitization financing for the Monterey Peninsula Water Supply Project could not extend to 30 years or longer.

It is noteworthy that the West Virginia securitizations were expressly intended to assist utilities with a credit rating below "investment grade" to borrow at a more advantageous rate. While American Water's credit rating is investment grade, it is barely so; thus the proposed securitization will have a similar purpose.

Another distinguishing feature of the District's proposal is that the securitization will take the form of a federally tax exempt borrowing, thus further lowering its cost and increasing ratepayer savings. A tax-exempt borrowing is authorized under Section 142(a)(4) of the Internal Revenue Code, assuming that a "private activity bond allocation" is made available by the State. The District believes, based upon inquiries, that such an "allocation" will be available from the State.

Finally, due to the tax-exempt nature of the offering, the Ratepayer Relief Bonds (as well as the underlying notes issued by the Cal-Am Special Purpose Entity (SPE)) will be exempt from registration under federal securities laws, providing further simplicity and potential savings to customers.

### **Estimated Cost Savings.**

The District estimates that cost savings to Cal-Am customers resulting from using securitization, compared to a traditional utility cost recovery mechanism, will be significant. Assuming a federally tax exempt securitization of approximately \$100 million, with AA credit ratings and a nominal maturity of 30 years, the District's advisors estimate an average weighted interest cost under current market conditions of 3.60%. When compared to a traditional recovery method, consisting of 47% debt and 53% equity, with an assumed borrowing rate of 5.0% and an equity return of 9.99%, the securitization should achieve present value savings of approximately \$54

---

(iv) Form S-1 filed by PE ENVIRONMENTAL FUNDING LLC, As filed with the Securities and Exchange Commission on December 15, 2009 - REGISTRATION NO. 333-163488

<sup>3</sup> Moody's Investors Service, Inc. Rating Methodology: Moody's Global Infrastructure Finance - "Regulated Electric and Gas Utilities." New York: Moody's Investors Service, Inc., August 2009, page 30

million.<sup>4</sup> However, actual benefits to the ratepayers will be subject to market conditions at the time of the financing.

### **Required Authorizations.**

The proposed securitization will require new legislation and a “financing order” to be issued by the CPUC pursuant to the legislation. The California legislature has previously approved several bills authorizing over \$8 billion of securitization, and the CPUC has issued at least five financing orders to date pursuant to that legislation. The legislation and financing order required for the proposed Cal-Am securitization will closely follow prior legislative and Commission precedent, and should present no novel issues of law.

### **Required Features of the Legislation and Financing Order.**

As with prior securitizations, the legislation will authorize the creation of a property right, consisting of the right to impose, collect and adjust from time to time a “non-bypassable” charge on Cal-Am customers on the Monterey Peninsula (“Peninsula customers”) sufficient to pay debt service and related costs of the securitization. The legislation will authorize the CPUC to issue an irrevocable “financing order” to enable the financing. The State will pledge under the legislation not to take any action to impair the rights of the Ratepayer Relief Bondholders. Pursuant to the legislation and the financing order, Cal-Am will sell the property right to a Cal-Am special purpose, bankruptcy-remote subsidiary (the SPE). The sale of the property right by Cal-Am to the SPE will be treated as a “true sale” for state law and federal bankruptcy purposes, thus allowing the securitization to be rated independently from the credit rating of Cal-Am. The SPE will issue notes payable from the non-bypassable charge imposed upon Peninsula customers.

Similar to the California “stranded cost” securitizations completed in 1997 and 1999, the Ratepayer Relief Bonds sold to the public will be issued by a public entity. In these earlier California securitizations, the issuer was also a public entity, a trust formed by the California Infrastructure and Economic Development Bank. The District proposes to be the issuer of the Ratepayer Relief Bonds in order to effect a “tax-exempt borrowing.” None of the prior California securitizations were implemented on a tax-exempt basis, because an appropriate exemption was unavailable. A tax-exempt borrowing will further enhance customer savings.

---

<sup>4</sup> Direct testimony of Robert Larkins, Raymond James & Associates, Inc in A.12-04-019 February 22, 2013

### **Transaction Structure.**

In order to implement a tax exempt issuance of Ratepayer Relief Bonds, the District proposes the following structure:

- Cal Am will sell its property interest to the SPE;
- The SPE will issue Ratepayer Relief Notes, which will be purchased by the District; and
- The District will issue tax-exempt Ratepayer Relief Bonds, mirroring the payment terms of the Ratepayer Relief Notes, to investors, with an expected rating in the AA or higher category.

### **Cal-Am's Role in the Securitization.**

Cal-Am will have several pivotal roles in the financing. First Cal-Am will be the sponsor of the financing and the financing order, and the seller of the securitization property. Cal-Am will create and capitalize the SPE (see Federal Tax Treatment below). And Cal-Am will act as a servicer of the securitization charges, and will be reimbursed from the securitization charges for its servicing and administrative costs.

As is customary in utility securitizations, it is anticipated that Cal-Am will be required to remit securitization charges daily to the bond trustee (within two business days of collection from customers). Daily remittances will minimize the risk to bondholders of a Cal-Am bankruptcy or insolvency, and will allow the securitizations to secure the highest possible credit ratings.

The parties to the securitization and the proposed flow of funds for the securitization are illustrated on Appendices C and D.

### **Federal Tax Treatment.**

The transaction should satisfy the IRS requirements for “debt-for-tax” treatment since it will comply with Rev. Proc. 2005-62.<sup>5</sup> In other words, for federal tax purposes, the transfer of the bond proceeds from SPE to Cal-Am will be a tax-free event; the transfer will be treated as a borrowing by Cal-Am. Under Rev. Proc. 2005-62, any regulated utility, including a water utility, can avail itself of the Rev. Proc. Under the Rev. Proc., Cal-Am will be required to capitalize the SPE with an amount equal to ½ of 1% of the initial principal amount of the Ratepayer Relief Bonds and will earn interest on the deposit.

---

<sup>5</sup> Rev. Proc. 2005-62, IRB 2005-37

### **Rating Agency Treatment.**

Standard & Poor's (S&P) has stated that it will disregard the non-recourse SPE debt in its determination of a credit rating of the utility. S&P has said "[n]evertheless, as long as the transaction is structured as a true sale for legal purposes, Standard & Poor's will 'back out' for analytical purposes nonrecourse debt and associated carrying costs from the utility's consolidated financial statements."<sup>6</sup> S&P has also stated: "For rate-regulated utilities, we remove the effects of debt related to securitization, to the extent that debt is serviced separately by the utility's customers through direct inclusion in rates. Because the customers, not the utility, are responsible, by statute, for principal and interest payments, we remove the debt from the balance sheet for analytical purposes."<sup>7</sup>

Fitch Ratings has also stated that it may disregard the non-recourse SPE debt in its credit rating analysis of the utility. Fitch has stated: "For those utilities that have issued utility tariff bonds supported by a dedicated tariff component, credit ratios are calculated after adjustment to exclude the effects of the tariff bonds on financial statements. In GAAP financial statements, the tariff bonds and associated revenues and expenses, as well as cash flows, are consolidated with the utility. However, the underlying trends in the utility's business are more easily understood by deconsolidating the affairs of the special-purpose entity (SPE) issuer of the tariff bond from the utility's general obligations for credit ratio analyses."<sup>8</sup>

---

<sup>6</sup> Standard & Poor's. Ratings Direct: Global Rating Portal – "Securitizing Stranded Costs." New York: Standard & Poor's, January 18, 2001, page 8

<sup>7</sup> Standard & Poor's. Ratings Direct: Global Credit Portal – "2008 Corporate Criteria: Ratios and Adjustments." New York: Standard & Poor's, April 15, 2008, page 35

<sup>8</sup> Fitch Ratings. Utilities, Power, and Gas North America Special Report – "Rating North American Utilities, Power, Gas, and Water Companies." New York: Fitch Ratings, May 16, 2011, page 23

**APPENDIX A**

**CALIFORNIA UTILITY SECURITIZATIONS**

<b>Utility</b>	<b>Transaction</b>	<b>Date</b>	<b>Amount</b>
Pacific Gas & Electric (PG&E)	PG&E Energy Recovery Funding LLC \$844,461,000 Energy Recovery Bonds, Series 2005-2	11/3/05	\$844,461,000
Pacific Gas & Electric (PG&E)	PG&E Energy Recovery Funding LLC \$1,887,864,000 Energy Recovery Bonds, Series 2005-1	2/3/2005	\$1,887,864,000
Sierra Pacific Power	California Infrastructure and Economic Development Bank Special Purpose Trust SPPC-1 \$24,000,000 Rate Reduction Certificates, Series 1999-1	4/8/99	\$24,000,000
Southern California Edison	California Infrastructure and Economic Development Bank Special Purpose Trust SCE-1 \$2,463,000,000 Rate Reduction Certificates, Series 1997-1	12/4/97	\$2,463,000,000
San Diego Gas & Electric	California Infrastructure and Economic Development Bank Special Purpose Trust SDG&E-1 \$658,000,000 Rate Reduction Certificates, Series 1997-1	12/4/97	\$658,000,000
Pacific Gas & Electric (PG&E)	California Infrastructure and Economic Development Bank Special Purpose Trust PG&E-1 \$2,901,000,000 Rate Reduction Certificates, Series 1997-1	11/25/97	\$2,901,000,000

**APPENDIX B**

**UTILITY SECURITIZATION LIST**

<b>State</b>	<b>Utility</b>	<b>Date</b>	<b>Amount (\$Million)</b>
Texas	AEP Texas Central Transition Funding	3/7/12	\$ 800
Texas	CenterPoint Energy Transition Bond	1/11/12	1,695
Louisiana	Entergy Louisiana	9/15/11	207
Arkansas	Entergy Arkansas	8/11/10	124
Louisiana	Entergy Gulf States Louisiana <sup>(1)</sup>	7/15/10	244
Louisiana	Entergy Louisiana <sup>(1)</sup>	7/15/10	469
West Virginia	MP Environmental Funding	12/30/09	64
West Virginia	PE Environmental Funding	12/30/09	22
Texas	CenterPoint Energy Restoration	11/18/09	665
Texas	Entergy Texas Restoration Funding	10/30/09	546
Louisiana	Entergy Gulf States Louisiana <sup>(1)</sup>	8/20/08	278
Louisiana	Entergy Louisiana <sup>(1)</sup>	7/22/08	688
Louisiana	CLECO 2008 - Hurricane Recovery	2/28/08	180
Texas	CenterPoint Energy	02/12/08	488
Texas	Entergy Gulf States	06/29/07	330
Maryland	Baltimore Gas and Electric	06/29/07	623
Florida	Florida Power and Light	05/22/07	652
West Virginia	MP Environmental Funding	04/11/07	344
West Virginia	PE Environmental Funding	04/11/07	115
Texas	AEP Texas Central Transition Funding	10/06/06	1,740
New Jersey	Jersey Central Power and Light	08/04/06	182
Texas	CenterPoint Energy	12/16/05	1,851
California	Pacific Gas & Electric	11/03/05	844
Pennsylvania	West Penn Power	09/22/05	115
New Jersey	Public Service Electric & Gas	09/09/05	102
Massachusetts	Nstar (Boston Edison)	02/15/05	674
California	Pacific Gas & Electric	02/03/05	1,887
New Jersey	Rockland Electric	07/28/04	46
Texas	TXU Electric Delivery	05/28/04	790
New Jersey	Atlantic City Electric	12/18/03	152
Texas	Oncor Electric Delivery	08/14/03	500
New Jersey	Atlantic City Electric	12/11/02	440
New Jersey	Jersey Central Power and Light	06/04/02	320
Texas	Central Power and Light	01/31/02	797
New Hampshire	Public Service of New Hampshire	01/17/02	50
Michigan	Consumers Energy	10/31/01	469
Texas	Reliant Energy	10/17/01	749
Massachusetts	Western Massachusetts	05/15/01	155
New Hampshire	Public Service of New Hampshire	04/20/01	525
Connecticut	Connecticut Light & Power	03/27/01	1,440
Michigan	Detroit Edison	03/02/01	1,750
Pennsylvania	PECO Energy	02/15/01	805
New Jersey	PSE&G	01/25/01	2,500

<b>State</b>	<b>Utility</b>	<b>Date</b>	<b>Amount (\$Million)</b>
Pennsylvania	PECO Energy	04/27/00	1,000
Pennsylvania	West Penn Power	11/16/99	600
Pennsylvania	Pennsylvania Power & Light	07/29/99	2,420
Massachusetts	Boston Edison	07/14/99	725
California	Sierra Pacific Power <sup>(2)</sup>	04/08/99	24
Pennsylvania	PECO Energy	03/18/99	4,000
Montana	Montana Power <sup>(2)</sup>	12/22/98	63
Illinois	Illinois Power	12/10/98	864
Illinois	Commonwealth Edison	12/07/98	3,400
California	Southern California Edison	12/04/97	2,463
California	San Diego Gas & Electric	12/04/97	658
California	Pacific Gas & Electric	11/25/97	2,901
Washington	Puget Sound Electric	7/30/97	35
	<b>Total</b>		<b>\$46,570</b>

Sources: Securities Data Corporation, Public Records, Morgan Stanley

<sup>(1)</sup> Issued as exempt municipal bonds

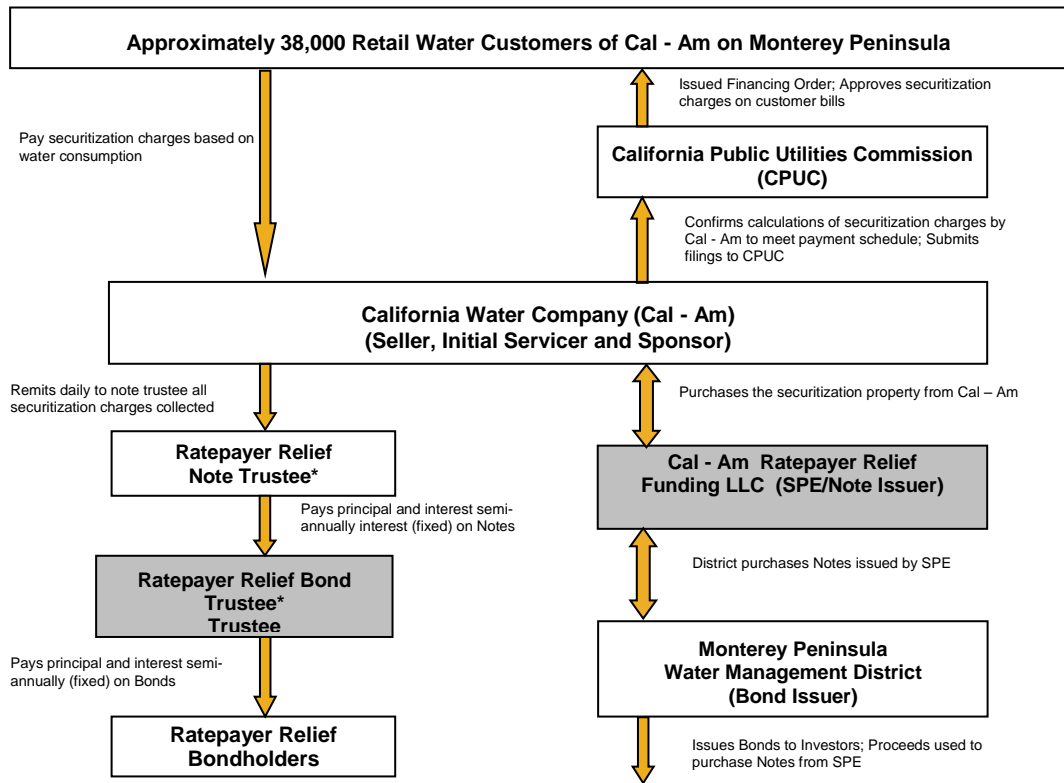
<sup>(2)</sup> Private offering



**APPENDIX C**

**PARTIES TO TRANSACTION AND RESPONSIBILITIES**

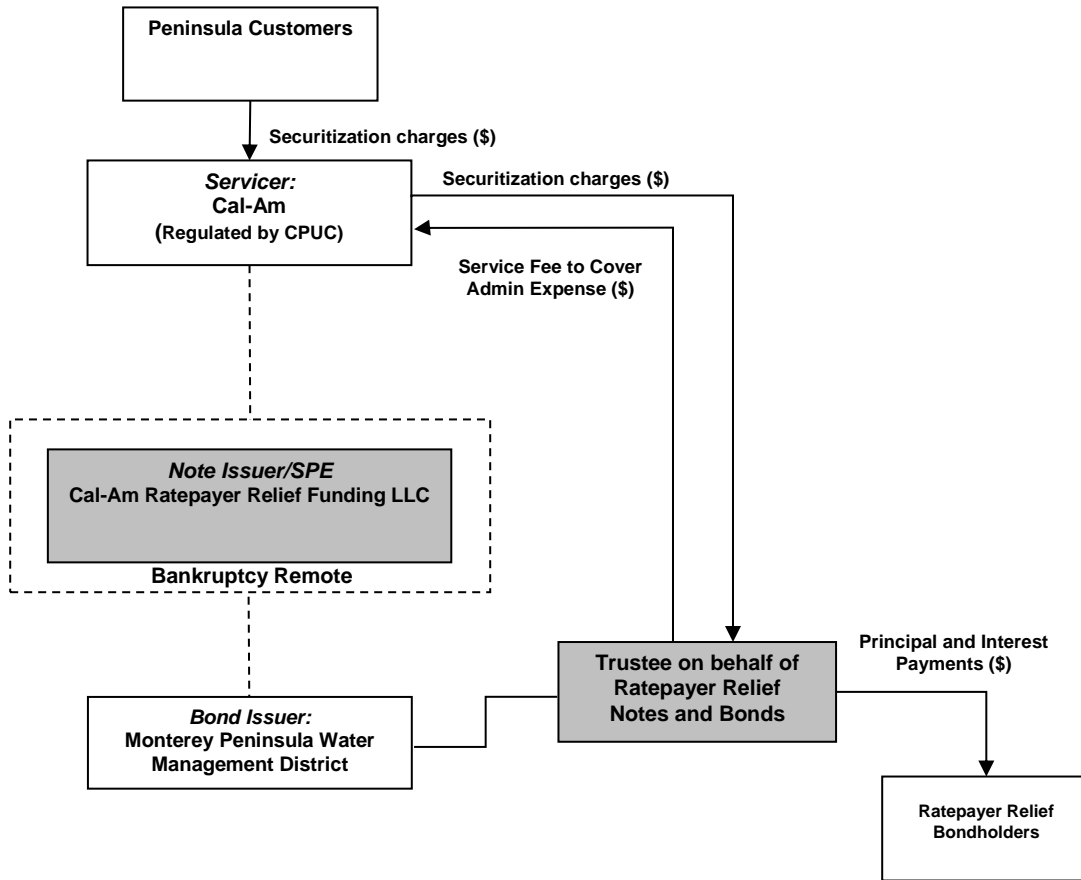
The following chart represents a general summary of the parties to the transactions underlying the offering of the Ratepayer Relief Bonds, their roles and their various relationships to the other parties:



\* Note Trustee and Bond Trustee will be same entity

**APPENDIX D**  
**FLOW OF FUNDS**

The following chart represents a general summary of the flow of funds:



\* Note Trustee and Bond Trustee will be same entity