RECOMMENDATION
Staff recommends that Council authorize the Mayor to execute the final settlement agreement between the City and County of San Francisco and the member agencies of the Bay Area Water Supply and Conservation Agency.

BACKGROUND
In 1984, Palo Alto and the other agencies and water districts who purchase water from the City and County of San Francisco (San Francisco) entered into a Settlement Agreement and Master Water Sales Contract (Master Contract) with San Francisco. The agencies and water districts that purchase water from San Francisco are the same as the member agencies of the Bay Area Water Supply and Conservation Agency (BAWSCA) and are collectively referred to in the Master Contract as the Suburban Purchasers.

Disputes in implementation of the terms and conditions of the Master Contract may be resolved by arbitration. In June 2002, an arbitration was requested by the five agencies (referred to in the Master Contact as the Suburban Representatives) who represent the BAWSCA member agencies in certain cases in the Master Contract: the Cities of Palo Alto, Redwood City, and Hayward, the Alameda County Water District, and the California Water Service Company, Inc. The Suburban Representatives disagreed with San Francisco regarding the calculation of the amount charged to the BAWSCA member agencies (the Suburban Revenue Requirement) for Fiscal Year 1999-2000.

DISCUSSION
The two issues in dispute related to: 1) double-counting of fixed assets; and 2) the proper allocation of design costs for a septic system at the Kirkwood powerhouse. San
Francisco and the BAWSCA member agencies approved a Partial Settlement Agreement in December 2002, which resulted in a credit to the BAWSCA agencies of $1.6 million. The Partial Settlement Agreement resolved the double-charging issue for assets going forward and for another issue identified in the investigation conducted after the arbitration filing: credit to the BAWSCA agencies for reimbursement San Francisco received from the Federal Emergency Management Agency for repairing facilities damaged in disasters. However, two issues remained unresolved: 1) double-counting of fixed assets in the period prior to FY 99-00, specifically FY 97-98 and FY 98-99; and 2) septic system design write-offs.

In January 2004, San Francisco agreed with BAWSCA’s position on the double-counting of assets and agreed to credit the Suburban Purchasers over $2 million to correct that problem. The issue of the $2.5 million written off by San Francisco as septic system design was investigated further and a variety of problems was discovered, primarily very bad record-keeping and inadequate accounting systems. It was discovered that the $2.5 million was not spent on septic system designs at Early Intake, a San Francisco power facility, that were subsequently abandoned, as represented by San Francisco, but included a long list of expenditures on projects such as waste treatment projects at O’Shaughnessy Dam, septic system design at Holm powerhouse, sewer system improvements at a campground at Tuolumne Meadows, as well as septic system plans and designs for Early Intake that actually were used. Only $957,000 could actually be attributed to faulty designs at Early Intake. All these corrections were added to the Final Settlement Agreement resulting in a total credit in the balancing account to the Suburban Purchasers of $2,094,621 for both issues.

Perhaps the most valuable element of the Final Settlement Agreement is concurrence to certain terms to improve the clarity and accuracy of San Francisco cost accounting in the remaining years of the Master Contract. Overall, the arbitration demand filed by the Suburban Purchasers in June 2002 resulted in a total savings of $3.6 million. The savings will result in lower wholesale water costs by approximately $300,000 in for FY 04-05 for Palo Alto.

**ATTACHMENT**
Final Settlement Agreement

**PREPARED BY:**

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