

EXHIBIT C

**SETTLEMENT PRINCIPLES
FOR REMITTANCES AND
SURPLUS REVENUES**

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SETTLEMENT PRINCIPLES FOR REMITTANCES AND SURPLUS REVENUES

This Exhibit C outlines the principles by which Utility will calculate revenues associated with surplus energy sales and DWR energy delivered to retail customers. This Exhibit C also addresses the information that Utility will provide to DWR to support DWR payment of Contract invoices, and invoices from natural gas supplier(s) for fuel provided to service DWR Contracts where tolling options have been implemented.

This Exhibit C works in conjunction with the Servicing Arrangement with Utility for purposes of determining the remittance amounts by Utility, which serves as DWR's billing and collection agent.

In accordance with the Contract Allocation Order¹, this Exhibit C provides that:

- Revenues will be allocated for both surplus sales and retail customer deliveries
- The principle of balancing least cost economic dispatch while maintaining reliability is reinforced through these revenue allocation protocols.
- Surplus sales quantities will be calculated as the difference between Utility's Energy Delivery Obligations (EDO) and the combination of energy from URG and energy dispatched from Contracts.

Where Utility's Energy Delivery Obligations is defined as Utility's retail load.

The principles herein, together with the applicable methods and calculations contained in the Servicing Arrangement, form a substantive component of the accounting protocols required to implement the Contract Allocation Order. This Exhibit should also be read in conjunction with Exhibit F ("Data Requirements"). The data requirements contained therein are essential to the establishment of accountability and responsibility of Utility to DWR in carrying out its obligations under this Agreement.

Based on last minute revisions to this Exhibit C, Exhibit F may need to be modified to include all data that DWR will require to verify the remittances of revenues. In addition, Exhibit F may periodically be modified to include all data that DWR will require to verify the remittances of revenues as remittance or implementation protocols change. Utility and DWR agree to modify Exhibit F to include or exclude information reasonably determined by DWR to allow DWR to verify Net DWR Retail Supply and the surplus remittances.

Utility Remittance to DWR

¹ Contract Allocation Order is CPUC Decision (D.) 02-09-053.

Utility shall remit to DWR an Energy Payment for the delivery of Contract energy to Utility retail customers and a separate payment for DWR's share of Surplus Energy Sales Revenues. The principles for the remittances to DWR of Surplus Energy Sales Revenue and Energy Payment are contained in Sections A and B of this Exhibit C, respectively. The details for determination of the remittances to DWR by Utility are contained in the Servicing Arrangement.

A. Utility Remittance to DWR of Revenue from Surplus Energy Sales

Surplus Energy and Revenues

Surplus energy exists when dispatched supply from Utility portfolio and DWR Contracts exceeds Utility's Energy Delivery Obligations. When such a condition exists, the revenues from the sale of surplus energy shall be shared between Utility and DWR. Surplus sale revenues can occur either through a forward market sale or a delivery of the excess energy into the ISO real time market.

Surplus Energy Quantity

The Surplus Energy Quantity shall be determined by subtracting EDO from the sum of dispatched Utility Supply and dispatched DWR Supply. Utility Supply shall include dispatched energy from URG, new Utility contracts and Utility market purchases plus adjustments described below. DWR Supply shall include dispatched energy from DWR must take and dispatchable contracts plus adjustments as described in the section captioned "SETTLEMENT PRINCIPLES FOR REMITTANCES AND SURPLUS REVENUES" below.

DWR Surplus Energy quantity shall be the product of Surplus Energy Quantity multiplied by the DWR Surplus Energy Percentage. Utility Surplus Energy quantity shall be the remaining portion of Surplus Energy. Both Utility and DWR Surplus Energy quantities shall be applied to the respective Party's energy supply quantities for determination of the Hourly Percentage Factor described in Section (B).

Surplus Energy Sales Revenues

Surplus Energy Sale Revenues shall be placed by Utility into a separate account ("Surplus Sales Fund") in accordance with protocols to be developed by Utility and reviewed and approved by DWR. It is the intent of the Parties that (i) DWR's share of Net Surplus Sales Revenues, and (ii) variable costs to dispatch appropriate units, are to be held in trust, segregated from general funds or revenues of Utility. For surplus energy sales to third parties, Utility shall apply reasonable credit risk management criteria, that is consistent with industry accepted credit standards.

Surplus Energy Sales Revenues shall be all amounts received from sale of all Surplus Energy Quantity, and shall be shared between Utility and DWR. The Parties will apply the following economic stacking assumptions set forth in this paragraph solely for remittance purposes under this Agreement. Utility and DWR will apply the following economic stacking of resources for Surplus Energy Sales Revenues settlements based on economic dispatch principles at the earliest date practical after execution of this Agreement. Upon addition or deletion of new resources, the Parties will review the economic stacking assumptions provided in this paragraph at the earliest date practicable following the change in the make-up of the integrated portfolio. The economic stacking of dispatchable resources will be based on the heat rate of each resource. The economic stacking of dispatchable purchases shall be based on an imputed heat rate of that purchase using a daily gas price.

Each of DWR and Utility will recover its transaction related costs and variable costs for each unit in the economic stacking above EDO, including variable cost to dispatch the unit and any share of transmission, brokerage, ISO and any other agreed charges. It is the intention of the Parties that "start-up costs" applicable to dispatched units solely for surplus energy sales purposes will be recovered based on a methodology to be mutually developed at the earliest date practicable. The amount resulting from Surplus Energy Sales Revenues after deducting all of the transaction related and variable costs shall be the Net Surplus Sales Revenues.

Net Surplus Sales Revenues shall be allocated between Utility and DWR in the same proportion as Surplus Energy Quantity.

DWR share of Net Surplus Sales Revenues shall be the product of Net Surplus Sales Revenues and DWR Surplus Energy Percentage. Utility's share of Net Surplus Sales Revenue shall be the remainder of Net Surplus Sales Revenue after deducting the DWR share of Net Surplus Sales Revenues. Transaction related costs and variable costs attributable to DWR Surplus Energy will be remitted to DWR and transaction related costs and variable costs attributable to Utility Surplus Energy

Utility will develop implementation protocols to substitute reasonable approximation in lieu of actual variable costs. Such protocols developed by Utility will be provided to DWR for review and shall be implemented upon DWR's approval at its sole discretion.

Forward Market Sale

DWR share of revenues from a forward market sale of surplus energy shall be the product of the net revenue multiplied by the DWR Surplus Energy Percentage. Utility share of these revenues shall be net revenue less DWR share of net revenues. Revenues from a forward market sale shall not be distributed to the Parties until after Utility receives the revenues from the sales and any sale-related charges. Shared revenues from forward market sale shall be net of transmission cost and broker fees.

ISO Real Time Market Sales

Revenues from delivery of surplus energy to the ISO real time market shall be determined from the product of positive load deviation multiplied by the ISO real time market price. These revenues will be netted against any ISO charges related to the load deviation, including a negative ISO price. Load deviation is determined by subtracting Final Hour Ahead Load Schedule from Utility metered load, however only positive quantities, where schedule exceeds meter, reflect surplus conditions for revenue sharing.

DWR share of revenues from delivery of surplus energy to ISO real time market shall be the product of the net revenues multiplied by the DWR Surplus Energy Percentage. Utility share of these revenues shall be the net revenue less DWR share of net revenues. Revenues from delivery of surplus energy to the ISO real time market shall not be distributed to the Parties until after Utility receives payment for final monthly invoice from the ISO for the month in which the surplus energy was delivered.

“Over-generation” Periods

During periods of over-generation condition as announced by the ISO, surplus sales may be made at very low, zero or even negative prices. In such conditions, the surplus sale revenue calculations as described above still hold. However it is recognized that the sales may result in little or no revenue. Sales could even be done at a cost to the seller. That seller could be Utility or the ISO selling in an “out-of-market” condition. During these conditions, ISO-related charges assigned to Utility for such sales (e.g. – ISO selling out-of-market) are included in the surplus sales revenue as a cost. During over-generation conditions there may be no market in which to sell surplus energy. In that event, or in expectation of that event, Utility shall declare that no valid market exists for surplus energy and shall begin curtailing must-take resources in accordance with Utility’s procedures for mitigating over-generation conditions. Such mitigation measures shall be consistent with good utility practice, specifically hydroelectric facilities at spill or near-spill conditions and nuclear facilities scheduled by Utility are the last resources to be reduced in power output.

Over-generation for purposes of this document is defined as the condition by which total supply exceeds total load in the ISO control area.

Revenues or costs from delivery of surplus energy to the ISO real time market under an over-generation condition shall not be distributed to the Parties until after Utility receives payment for final monthly invoice from the ISO for the month in which the surplus energy was delivered.

Calculation of Surplus Energy Percentage

DWR Surplus Energy Percentage shall be equal to the pro rata share of DWR Supply to the sum of Utility Supply and DWR Supply, expressed as follows:

$$DWR \text{ Surplus Energy Percentage} = DWR \text{ Supply} / (Utility \text{ Supply} + DWR \text{ Supply})$$

Where:

DWR Supply is total energy dispatched from DWR Allocated Contracts with adjustments for transmission losses, Ancillary Services and ISO Instructed Energy transactions described below.

Utility Supply is total energy dispatched from URG, new Utility contracts and Utility market purchases with adjustments for transmission losses, existing Utility wholesale obligation, WAPA load², Ancillary Services and ISO Instructed Energy, exchange transactions, net deviations as described below.

SETTLEMENT PRINCIPLES FOR REMITTANCES AND SURPLUS REVENUES

Definitions and Adjustments

Certain energy and capacity transactions, which may be conducted by Utility in its normal course of business, may affect the Utility and DWR Supply quantities used in pro rata calculations.

Exchanges are transactions where energy is delivered to a third party in one period and a similar, but not necessarily equal, amount of energy is returned by third party in a different period. For the purposes of remittance determination, exchanges use and supplement energy from the Utility Supply.

² On an interim basis applicable to prospective remittances beginning in 2003, the Parties have agreed to treat Utility's WAPA integration contract as an obligation of Utility served solely by URG. However, use of this interim approach is without prejudice to either Party's position on the issue or waiver of any of Parties' legal rights and the Parties agree that Utility will submit this issue to the Commission for its determination.

Forward Sales are transactions where energy is sold in a forward market to balance supply with demand. In general, for the purposes of remittance determination, forward sales are made using energy from the joint Utility/DWR portfolio.

Ancillary Services are transactions where capacity from certain qualifying resources is sold to ISO for ancillary services rather than being used as energy to serve retail load. Resources from both Utility portfolio and DWR Contracts may qualify for use as ancillary services. Since the capacity used for ancillary services does not serve retail energy load, ancillary service capacity is not considered as a joint Utility/DWR portfolio transaction for the purpose of remittance determination. If Utility or DWR Contract resource capacity is used for ancillary services, the capacity quantity will not be included in the supply quantity of the owning party for the purpose of pro rata share calculations, and owning party will retain all the revenues from the ancillary services as well as all associated transaction costs and ISO charges.

ISO Instructed Energy is a transaction where certain qualifying resources are able to sell energy from unused capacity to the ISO in the real time market. The energy delivered from these resources is directed by the ISO in real time to balance supply and load imbalances on the grid. Either Utility portfolio or DWR Contracts may contain resources that have ability to provide instructed energy to ISO. Since instructed energy is resource specific and does not directly serve the retail load of any utility, instructed energy is not considered as a joint Utility/DWR portfolio transaction for the purpose of remittance determination. If Utility or DWR Contract resources are dispatched as instructed energy, the energy quantity will not be included in the supply quantity of the owning party for the purpose of pro rata share calculations, and owning party will retain all the revenues from the instructed energy as well as all associated transaction costs and ISO charges.

ISO Uninstructed Energy is a transaction where energy is delivered or received from the ISO grid in the real time based on the actual consumption of retail load and actual deliveries of supply resources. The ISO nets the deviations of load and supply from schedule in a single deviation quantity and issues a charge or credit based on net deviation and ISO real time market price. The net deviations would be applied to the Utility Supply.

Transmission Losses

Transmission loss is defined as Energy that is lost due to process of transmitting energy from supply source to load. Therefore,

supply resources from DWR Contracts and Utility Supply have distinct and identifiable quantity of transmission losses. Utility and DWR Supply should be net of transmission losses because energy that is delivered to retail customer (i.e. load) equals quantity of supply less losses.

B. Utility Remittance to DWR for Sales of DWR Energy to Utility Retail Customers –Energy Payment

Utility shall remit to DWR its Energy Payments according to the terms of each Utility's respective Servicing Arrangement.

The DWR Energy Payment is billed by each utility to customers in accordance with the terms of each applicable Utility Servicing Arrangement. The DWR Energy Payment is billed kWhs served by Net DWR Retail Supply at the applicable CPUC approved DWR rate. The DWR Energy Payment is allocated based on the percentage of energy supplied by DWR to Utility, which is the "Hourly Percentage Factor" multiplied by the retail load of each customer. The Hourly Percentage Factor is determined by calculating the percentage of net energy supplied by DWR to Utility to serve retail load, as expressed below:

$$\text{Hourly Percentage Factor} = \text{Net DWR Retail Supply} / (\text{Net Utility Retail Supply} + \text{Net DWR Retail Supply})$$

Where:

Net DWR Retail Supply is the actual DWR Supply quantity used for the determination of actual Total Retail Supply.

Net Utility Retail Supply is actual Utility Supply quantity used for the determination of actual Total Retail Supply.

Net Utility Retail Supply plus Net DWR Retail Supply equals EDO. EDO equals Total Retail Supply.

Total Retail Supply is determined by aggregating, without regard to ownership, sufficient DWR Supply and Utility Supply to meet, but not exceed, the EDO in each hour. Total Retail Supply is determined based on the economic stacking established in Section A, commencing with must-take, then the least cost heat rate and ending with the highest cost heat rate unit required to meet EDO. Where the aggregate of must-take supply (all resources where the variable cost to dispatch is virtually zero dollars per MWh) exceeds the EDO, the supply attributable to Net DWR Retail Supply and Net Utility Retail Supply will be determined in proportion to the total of must-take (including must-run) supply and any surplus

energy from must-take supply would also be allocated in the same proportion.

II. Bilateral Settlement

Under the Contract Allocation Order DWR remains financially obligated for the Contracts. DWR will continue to pay suppliers and this requires DWR to apply appropriate procedures and controls to ensure that payments are made accurately and in a timely manner. Both for these purposes and for purposes of accruing revenue due, DWR will require hourly schedule data. Information supporting Contract settlements will be provided by Utility, and additional information may also be required to address contract performance issues (such as availability and other items as discussed in Exhibit E) and to allow DWR to settle disputes in an appropriate manner.

DWR requires sufficient information to support payment requests so that it can meet the accountability requirements of the State Controller's Office and the State Auditor, and simultaneously comply with the applicable statutes concerning disbursement of public monies. The Utility shall reconcile schedules with suppliers invoice . DWR shall make the associated payments to suppliers after performing its verification, and Utility will provide the data as required in Exhibit F to allow it to perform these duties in a timely manner as set forth herein.

DWR shall continue to perform validation of settlement data and invoices and pay Contract costs directly to the suppliers.

III. Fuel Cost Verification and Settlement

Exhibit B provides a detailed discussion concerning Utility's responsibility for fuel management. DWR will continue to pay fuel suppliers and others involved in providing fuel management services for the delivery of fuel for those DWR Contracts where the Fuel Option has been elected. Consistent with the above, Utility will perform settlements activities to reconcile quantities and associated charges, and DWR will perform verification, audit and monitoring to support its disbursement of funds. Utility will comply with the requirements contained in Exhibit F to provide DWR with the necessary information to apply appropriate procedures and controls to ensure that fuel payments and payments for fuel management services are made accurately and in a timely manner and to allow DWR to settle disputes in an appropriate manner.