



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

March 6, 2016

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90065-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

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City of San Diego

Fallbrook
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Helix Water District

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OTHER REPRESENTATIVE

County of San Diego

RE: March 7 Finance and Insurance Committee/Budget and Rates Workshop #3
Agenda Items 9-2 (Proposed revenue requirements) and 8d (Presentation); and

March 8 Board Meeting Agenda Item 4
Public Hearing RE suspension of tax rate limitation and proposed water rates and
charges for calendar years 2017 and 2018

Chair Record and Members of the Board:

We request this letter be made part of the record of Monday's Finance and Insurance
Committee Meeting and Tuesday's board meeting.

MWD's budget and rate-setting process suffers from a lack of transparency: As stated in our
February 9, 2016 letter to the board (attached, with all attachments), we object to MWD holding
a public hearing on rates and taxes without providing MWD's member agencies and the public
with budget information or a cost of service report sufficient to explain -- and allow the public to
review and understand -- how MWD intends to spend public money, allocate its costs and set its
rates. Holding a public hearing -- or a lot of board meetings and workshops -- without this
information, is form over substance and fails to meet the most basic ethics and transparency
requirement necessary to maintain the public trust. The fact that a trial court has ruled MWD's
rates are illegal should result in more, not less, disclosure, in the interest of understanding the
basis of MWD's rates.

***The Water Authority continues to object to MWD's cost allocation and rates and charges that
have been invalidated by the Superior Court:*** While MWD has not released its cost of service
report, it has made written statements that the proposed rates and charges are based upon the
same flawed and illegal methodology that the Court in *SDCWA v. MWD* rejected. We object to
the proposed rates for the same reasons we have previously objected: because they improperly
allocate all of MWD's SWP costs to transportation; and because the Water Stewardship Rate is
an unlawful tax that is not based on cost of service (or even tied to any service at all) and which
certainly may not be recovered as a transportation rate.

MWD's rates and charges can't be analyzed without more budget information, a cost of service report and the financial planning model used to allocate costs and set rates: The "estimated" rates and charges have finally now been identified as the "proposed" rates and charges in Board Memo 9-2; however, there is still no cost of service report explaining how MWD's costs have been allocated and assigned to the proposed rates, as described. The Water Authority has repeatedly requested this information from MWD, including most recently through a Public Records Act request. While MWD has indicated that it will make disclosable information available, it obviously will not do so prior to Tuesday's public hearing. MWD is also taking the position that its financial planning model, through which its rates have been calculated, and without which its rates cannot be analyzed, is a "propriety" software program that will not be made available to MWD's member agencies or to the public. It is not in the public's best interest or in MWD's best interest to conduct its ratemaking under a shroud of secrecy. (See attached letters dated February 18, February 26 and March 4, 2016 between the Water Authority and MWD's General Counsel.)

Lack of budget detail limits the board's ability to choose to reduce costs rather than raise rates or borrow money: As stated in our February 6, 2016 letter RE Board Memo 8-2 on the proposed budget and "estimated" rates, the staff's refusal to provide budget detail to the board of directors eliminates its ability to review proposed expenditures at a level of detail that would allow the board to determine whether it is in MWD's best interest to cut costs rather than raise rates or borrow more money. This should be of a particular interest given this month's staff recommendation to borrow money at a higher cost to pay operational expenses. It is also of serious concern to us that the proposed budget includes a gimmick such as the "Resolution of Reimbursement," giving staff advanced authorization to later raid PAYGo revenues to pay for O&M (an action that would likely violate cost of service laws in the process). Staff's refusal to provide budget detail should be a matter of grave concern to every member of this board of directors; we cannot possibly provide oversight based on PowerPoint presentations and the departmental budget numbers the staff has provided.

There is no basis for suspension of the tax rate limitation, especially when MWD is at the same time recommending reduction of the Readiness to Serve (RTS) charge: We have written many times about why there is no factual or legal basis for MWD's suspension of the tax rate limitation imposed by the Legislature, now embodied in Section 124.5 of the MWD Act. [See, e.g., our August 15, 2015 letter (copy attached, without attachments.)] With this tax rate suspension, MWD will collect over the next two years almost five times the amount of tax revenue otherwise allowed under its Act. MWD does not need to suspend the tax rate limitation; it needs a long range finance plan to responsibly structure how it will pay for current and anticipated costs, including increased costs of the State Water Project. There is clearly no basis for MWD to impose higher property taxes to ensure its "fiscal integrity," at the very same it is proposing to decrease by double digits its other fixed charges, including the RTS charge, which is the very tool the Legislature gave MWD to enable it to reduce taxes but maintain fixed cost recovery.

ALTERNATIVE TREATMENT COST RECOVERY MECHANISM

We would like to emphasize at the outset that we and the Water Authority support prudent fixed cost recovery by MWD through cost-of-service-based rates and charges reflecting member agencies' respective burdens on, and benefits received from MWD investments. To be successful, the benefits of these investments must be identified in advance, with the concurrence and agreement of the member agencies that benefit to pay for those benefits. (See Blue Ribbon Task Force Report dated January 1994, Part I, discussing the importance of integrating MWD's IRP and rate structure and warning about the risks associated with MWD making major capital investments when no agency is legally obligated to pay.)

MWD's February proposal for fixed treatment cost recovery is legally flawed. Even though the "alternative treatment cost recovery mechanism" is not among the proposed rates described in Board Memo 9-2, it remains in the presentation to be made at Workshop #3. Accordingly, we provide comments on the PowerPoint presentation at the Finance and Insurance Committee Meeting dated February 23, 2016 (copy attached).

The Proposal does not "Align Charges with Service Commitment/Investment" (slide 5): The statutory duties of a special district, formed under general law, are established by the entity's authorizing act. Whatever treatment facilities and improvements MWD has elected to operate for its convenience or at the request of one or more member agencies does not create or impose a "duty" to provide treatment services. Thus, the foundational objective to "align charges with MWD's service obligation" -- is flawed; , contrary to statements in the presentation, MWD is not "the treated water service provider for Member Agencies," and absent a contract, it does not have a service "obligation" or "duty to serve" treated water to its member agencies. To the contrary, as stated in its Official Statement, MWD's member agencies "are not required to purchase or use any of the water available from MWD." (See, for example, December 9, 2015 Official Statement at A-27.)

What MWD has is its own service "policy" (Laguna Declaration) and "desire" to serve water – treated and untreated -- to its member agencies; however, without a contractual agreement, that self-declared desire alone does not establish a duty to serve on the part of MWD or an obligation to purchase water from MWD by its member agencies. MWD has no power to restrict the rights of water suppliers within its service area to provide water and water treatment to their customers. Accordingly, there is no legal basis for a claim by MWD of legal protection from member agencies exercising their sovereign right to develop and treat water supplies. This is the very reason why the Blue Ribbon Task Force identified -- more than 20 years ago -- the need for MWD to obtain meaningful member agency commitments to pay before it embarks upon large capital spending projects like treatment plants.

Because we are not aware of, and independent research has not disclosed any authority for the proposition that MWD has a statutory duty to treat the wholesale water it provides, we strongly recommend that the General Counsel provide the board with a legal opinion that supports the

assertion that MWD has a legal duty or obligation to serve. The General Counsel should provide this opinion to the board so it may better understand the risks it is taking when it chooses to make investments in a declining sales market, when its member agencies increasingly are developing -- and should be encouraged to develop -- other cost-competitive local water supply resources. Aside from the risk factor, MWD cannot properly conduct a cost of service analysis based on flawed legal assumptions.

Determining the allocation of fixed treatment costs based on a proportional share of volume during the period 1998-2007 does not conform to proper cost of service methodologies: No cost of service based explanation is provided (and none exists) for assessing fixed treatment cost recovery based on the date of the last "significant treatment plant capacity addition." This is yet another result-oriented, arbitrary rate designed to benefit some agencies at the expense of others.

Allowing two different tests for minimum demand violates the MWD Act's requirement that rates be uniform: No cost of service based explanation is provided (and none exists) for assigning agencies to alternative measures of minimum demand to determine cost recovery. The underlying data should be the measure of cost recovery.

It is not possible from the information provided in the PowerPoint presentation (or that has otherwise been made available by MWD) to determine what costs have been allocated to fixed vs. variable categories; or, what fixed costs are defined as commodity, demand and standby related: We have previously requested the budget and cost of service data necessary to understand how MWD has allocated its costs and set its proposed rates, including the potential for imposition of an alternative fixed treatment charge. The data that has been provided is fragmentary and out of context. We again request to be provided with the detailed data and supporting detail for the cost allocation formulae for this and other rates and charges.

Finally, the statement that, "MWD has invested in treatment capacity to serve the Member Agencies, but today does not require the beneficiaries of demand or standby capacity to pay anything for the cost of this dedicated capacity; for the cost of this service," is inaccurate. In the first place, MWD has not dedicated any of its plant capacity to any member agency; second, this cost is recovered in the current volumetric treatment rate. If MWD's statement were true, then there would be additional revenue raised by the fixed plus volumetric approach. But this is not the case, because the total revenue requirement presented by MWD for the fixed plus variable alternative is the same as the current methodology. The current 100 percent volumetric methodology collects revenues equal to the "alternative."

The only thing that is clear from the information that has been provided is the intention to alter MWD's current treatment cost recovery, as between and among its member agencies, without any demonstrated factual basis for doing so. While an alternative treatment cost recovery mechanism might be justified based on member agencies' causation of those treatment costs and within that limit, and the board's discretion to set legal rates and charges, the current

proposal falls short of that objective. It is a sham, not based on cost causation but designed solely to achieve the results described at slide 27 of the Presentation, principally, to shift additional costs to the Water Authority without any cost justification for doing so.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachments

1. February 9, 2016 Letter to MWD re 2016 Rate Setting Process and Schedule for Public Hearing and Request for Distribution of Cost of Service Report Prior to the Public Hearing (with attachments)
2. February 18, 2016, February 26, 2016, and March 4, 2016 Letters between MWD and the Water Authority re PRA request
3. August 15, 2015 Letter to MWD re Ad Valorem tax rate suspension (without attachments)
4. February 3, 2016 MWD PowerPoint Presentation: Alternative Treatment Cost Recovery Mechanism
5. Blue Ribbon Task Force Report dated January 1994, through Part I: integration of MWD's IRP and rate structure



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February 9, 2016

Randy Record

Members of the Board of Directors

Metropolitan Water District of Southern California

P.O. Box 54153

Los Angeles, CA 90054-0153

RE: 2016 Rate Setting Process and Schedule for Public Hearing
Request for Distribution of Cost of Service Report Prior to the Public Hearing

Dear Chairman Record and Members of the Board:

At yesterday's Finance and Insurance Committee meeting, the Chief Financial Officer, Gary Breaux, informed the Board that MWD's 2016 Cost of Service Report (which is the basis of its proposed 2017 and 2018 rates), will not be presented to the Board or made available to the public until the Board's planned Workshop #4, scheduled for March 22, 2016. **That is two weeks AFTER the public hearing on the proposed rates and just three weeks prior to the April 12 board meeting when the rates are proposed to be adopted.** This schedule gives the public NO time to review the Cost of Service Report prior to the public hearing, and severely limits the amount of time available for MWD's member agencies to review and analyze the Cost of Service Report, data and analysis.

In a Feb. 4 letter (attached) to Dawn Chin, Clerk of the Board, the Water Authority formally requested "...all of the data and proposed methodology MWD will rely upon for establishing rates, charges, surcharges, surcharges or fees for 2017 and 2018... in accordance with Government Code Section 54999.7 (d) and (e), which necessarily includes its cost of service report. This law requires MWD to provide *all* of this data no later than 30 days before rates and charges are adopted. The planned March 22 release of the cost of service report does not comply with this requirement. While MWD's general counsel has previously contended in correspondence, and MWD contended in court that it is not required to comply with Government Code Section 54999.7, Judge Karnow specifically ruled 54999.7 applies to MWD.

Aside from the law requiring MWD to make this information available in a timely fashion to affected public agencies such as the Water Authority (and the rest of MWD's customer member agencies), there is an even more fundamental concern with holding a public hearing on MWD's rates without making available to the public in advance, the cost of service report explaining

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MWD Chairman Record and Members of the Board

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how MWD has allocated its costs and is proposing to set its rates.

How can the public intelligently comment on rates, when the basis for setting those rates has not been made available? Conducting a public hearing without providing the most basic information explaining the proposed action by the Board not only lacks transparency, but frustrates the very purpose of having a public hearing to obtain input on legislative decisions in matters of public policy.

As noted in our February 6, 2016 letter (attached), the Cost of Service Report and analysis has historically been made available to the Board and public at the same time as the proposed budget, in January or February of each year, thus allowing a meaningful time for review. We object to this new schedule and ask that either the Cost of Service Report be made available at least 30-days prior to the scheduled public hearing, or, that the public hearing and rate-setting schedule be adjusted to allow at least 30 days for review by all affected public agencies and members of the public.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachment 1: Water Authority Acting General Counsel's February 4, 2016 letter RE Request for Data and Proposed Methodology for Establishing Rates and Charges

Attachment 2: Water Authority Delegates' February 6, 2016 letter RE Board Memo 9-2



San Diego County Water Authority

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MEMBER AGENCIES

February 4, 2016

Carlsbad
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OTHER
REPRESENTATIVE

County of San Diego

Dawn Chin
Clerk of the Board
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

**Re: Written Request for Notice (Government Code Section 54999.7(d));
Request for Data and Proposed Methodology for Establishing Rates and Charges
(Government Code Section 54999.7(e))**

Dear Ms. Chin:

The San Diego County Water Authority hereby requests notice of the public meetings and to be provided with all of the data and proposed methodology MWD will rely upon for establishing rates, charges, surcharges or fees for 2017 and 2018 (and any other years that may be before the board during the current rate cycle) in accordance with Government Code Section 54999.7(d) and (e).

Please contact me if you have any questions.

Sincerely,

James J. Taylor
Acting General Counsel

cc: Maureen Stapleton, SDCWA General Manager
Jeffrey Kightlinger, MWD General Manager
Marcia Scully, MWD General Counsel



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OTHER REPRESENTATIVE

County of San Diego

RE: Board Memo 9-2: Proposed biennial budget and revenue requirements for fiscal years 2016/17 and 2017/18; estimated water rates and charges for calendar years 2017 and 2018 to meet revenue requirements; and ten-year forecast

Dear Chairman Record and Board Members:

The purpose of this letter is to provide preliminary comments and questions on Board Memo 9-2, proposed biennial budget and revenue requirements (collectively, the "Budget Document") in advance of the budget and rate workshops that begin with Monday's Finance and Insurance Committee meeting.

1. The Budget Document lacks sufficient detail to understand how MWD has spent money or deliberate how MWD is proposing to spend money. As one example, among many, MWD's proposed Demand Management cost summary does not identify any of the projects included in either Local Resources Program (\$43.7 and \$41.9 million, respectively for the respective fiscal years) or Future Supply Actions (\$4.4 and \$2 million, respectively). The budget also lacks projected actual expenditures for fiscal year (FY) 2016; instead, all comparisons are budget to budget. It is important for Board members to consider actual expenditures as well as proposed budgets, particularly in light of the very substantial additions and modifications to spending that occurred outside of the 2014 budget after it was adopted -- in the hundreds of millions of dollars. We request to be provided with greater detail explaining the proposed expenditures at a detail level sufficient to allow the Board to deliberate where savings might be achieved, as well as to understand the status or outcomes of past programs and expenditures.

2. The Budget Document does not provide any cost of service analysis and lacks sufficient detail to understand how MWD's costs should be assigned to rates. Different than past years, the current Budget Document **does not include any cost of service analysis**. Why has that not been provided? In addition, the Budget Document does not provide a sufficient level of detail or information in order for MWD to defend its rates and establish "**cost**"

causation" in accordance with legal requirements. Using the Demand Management cost summary again as an example, it is impossible to identify the proportionate benefits to MWD's customer member agencies resulting from the proposed expenditures. Broad, unsupported statements, such as "demand management programs reduce reliance on imported water," and "demand management programs reduce demands and burdens on MWD's system," are legally insufficient to comply with the common law or California statutory or Constitutional requirements that require MWD to conform to cost of service.

While we understand that MWD has appealed Judge Karnow's decision in the rate cases filed by the Water Authority, there is an increasing body of case law reaffirming these requirements, and clearly establish that they are applicable to water suppliers such as MWD. As one example, we attach a copy of the recent decision of the court in *Newhall County Water District v. Castaic Lake Water Agency*, where a number of arguments by Castaic that are very similar to those made by MWD were again rejected by the Court of Appeal. Chief among them was the argument that the water wholesaler need only identify benefits to its customers "collectively," rather than in a manner that reflects a reasonable relationship to the customers' respective burdens on, or benefits received from the wholesale agency's activities and expenditures. Contrary to these clear legal requirements, MWD's current Budget Document does not provide sufficient information to allow Board members or MWD's 26 customer member agencies to determine proportionate benefit from MWD's proposed expenditures. We repeat here for these purposes, our request to be provided with a greater level of detail regarding MWD's proposed spending, as well as the basis upon which MWD has assessed or may assess proportionate benefit to its customers. We also believe the Board would benefit from a public presentation on current and developing case law regarding the applicability of Proposition 26 to wholesale water agencies such as MWD, so that it is informed of its legal obligations as Board members in setting rates.

3. The Budget Document does not provide any analysis or data to explain or support the wide range of variation in proposed increases and decreases in various rate categories. The budget describes an "overall rate increase of 4%;" however, that is a meaningless number outside of the context of specific rates and charges as applied to MWD's 26 customer member agencies, which depends on the type of service or water they buy and what they pay in fixed charges. **The following rate increases and decreases are proposed for each of the respective fiscal years, without any data or analysis to explain them:**

- Tier 1 supply rate increases of 28.8% and 4%;
- Wheeling rate increases of 6.2% and 4.5%;
- Treatment surcharge decrease of 10.1%, followed by an increase of 2.2%;
- Full service untreated rate increases of 12.1% and 4.4%;
- Full service treated rate increases of 3.9% and 3.7%;
- Readiness-to-Serve (RTS) charge decreases of 11.8% and 3.7%; and
- Capacity Charge (CC) decrease of 26.6%, followed by an increase of 8.8%.

There is no demonstration in the Budget Document that MWD's expenses recovered by the RTS

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and CC will vary to such a degree in FYs 2017 and 2018 to support the very substantial proposed decreases in those fixed charges. Moreover, these sources of fixed cost recovery are being reduced at the very same time MWD is proposing to add fixed treatment cost recovery and suspend the property tax limitation under Section 124.5. In addition to the inconsistent logic, MWD is reducing the very charges authorized by the Legislature in 1984 so MWD could have more fixed revenue in lieu of its reliance on property taxes. MWD's proposed rates are precisely contrary to the intent of Sections 124.5 and 134 of its Act (copies attached). We ask that the General Counsel provide a legal opinion why MWD's actions are not the opposite of what was intended by passage of these provisions of the MWD Act.

Absent a justification that is not apparent from the Budget Document, these proposed rate increases and decreases appear to be arbitrary and unreasonable. We ask for the Board's support to require staff to provide both **data and analysis** to support these proposed rates and charges so that they may be understood and demonstrated to be based on cost causation principles.

4. The Budget Document mischaracterizes the Board's PAYGo funding policy and past actions; and is now proposing a "Resolution of Reimbursement" to formally authorize use of PAYGo revenues to pay for O&M, if necessary. The Board's PAYGo funding policy was historically set at 20 percent. See attached excerpt from the Board's July 8, 2013 Finance and Insurance Committee meeting. However, MWD staff has for the last several years been using PAYGo funds on an "as- and how-needed" basis. The Board has never deliberated or set a PAYGo "target" or "policy" at 60 percent. Moreover, contrary to what is stated in the Budget Document, the 2014 budget included CIP PAYGo funding at 100 percent, with the 2014 ten-year forecast stating that it "anticipates funding 100% of the CIP from PAYG and Replacement and Refurbishment (R&R) funds for the first three fiscal years, then transitioning to funding 60% of the CIP from water sales revenues." The absence of a Board policy being applied consistently not only fails to accomplish the purpose of PAYGo funding -- to equitably distribute costs of the CIP over time -- but exposes MWD to further litigation risk as funds that are collected for one purpose (CIP) are used for a different purpose (O&M).

The Board should not adopt the recommended "Resolution of Reimbursement" authorizing staff in advance to collect \$120 million annually for one purpose (CIP) and potentially use it for another (O&M). This is not only an unsound fiscal strategy, it serves to mask the true condition of MWD's budget and finances, and breaks any possible connection to cost of service. The Board should make a decision now on whether to raise rates, plan to borrow money or, notably at this point in the budget process, **reduce costs** (see also discussion of sales projections, below). The General Manager has told the Board (during its discussion of unbudgeted turf removal spending last year) that a 7 percent rate increase is necessary to support \$100 million in spending. Advance approval and use of PAYGo funds for O&M is nothing more than a hidden, de facto 8.4 percent additional rate increase each year.

5. *The 1.7 MAF MWD sales estimate for the next two fiscal years is likely too high and if so, will leave the Board with an even larger revenue gap to fill; and the Budget Document lacks a fiscally sound contingency plan.* The sales estimate may be too high given MWD's current trend at 1.63 MAF (a "sales" number that (at best) misleadingly includes the Water Authority's wheeled water) and El Nino conditions that make it unlikely that agencies will increase demand for MWD water. Further, while the board memo states the sales forecast accounts for 56,000 AF/year of new local supply from the Claude "Bud" Lewis Carlsbad Seawater Desalination Plant and Orange County Water District's expanded groundwater recycling project, no provision has been made for increased local supplies that may reasonably be projected to be available to the Los Angeles Department of Water and Power (LADWP). With a good year on the Eastern Sierra -- which is presently tracking the best snow pack on record -- MWD sales could be reduced by 250,000 AF or more, which translates to a negative revenue impact on MWD of between \$175 million and \$350 million.

It is MWD's obligation to forecast revenues responsibly, based on known and reasonably anticipated conditions, and plan for the contingency of reduced sales using responsible financial management techniques, which do not include budget gimmicks such as adoption of a "Resolution of Reimbursement" to shift CIP/PAYGo money to other uses.

We call to the Directors' attention that the proposed budget for FY 2017 already includes a revenue deficit of \$94.2 million, with MWD intending to withdraw from its reserves to bridge the gap. Similarly, the budget for fiscal year 2018 relies on \$23 million from reserves to fill the gap. Since sales may also be less than projected -- as they very well may be, for the reasons noted above -- the Board must plan now how the revenue gap will be filled. In this regard, we attach another copy of our November 17, 2014 letter suggesting the establishment of balancing accounts, allowing the Board to properly manage between good years and bad, rather than spending all of the money in good years (as it did this past year on turf removal) and needing to raise rates, borrow money or engage in the kind of gimmick represented by the Resolution of Reimbursement. We also ask that discussion of this issue be added to the next budget meeting agenda.

6. *There is no demonstrated justification for suspension of the ad valorem tax limitation.* As noted above, MWD is proposing in this budget to **reduce** the very charges the Legislature provided to MWD to be used in lieu of property taxes. Under these and other circumstances, there is no proper basis for MWD to suspend the tax rate limitation; instead, it should use the tools provided by the Legislature and included in the MWD Act.

7. *No information is provided regarding the proposed changes in treatment cost recovery.* Leaving aside the complete inconsistency with increasing fixed treatment cost recovery while reducing fixed cost recovery overall, when will the detail on the new charge be available?

MWD Chairman Record and Members of the Board

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8. The Budget Document does not explain why MWD's debt service coverage ratios for 2017 and 2018 are dropping from 2x to 1.6x. A comparison of the financial indices between this 2016 budget and the 2014 forecast shows a difference of only 50,000 AF of water sales reduction each year, yet the debt service ratios are plummeting from 2x to 1.6x. This drop is potentially very disturbing based on the aggressive water supply development plans MWD staff included in the IRP (and upon which it stated that spending decisions would be proposed and made). This is an important issue and policy discussion the Board must address.

9. The CIP numbers contained in the Budget Document don't match the Appendix. The Budget Document includes annual CIP expenditures of \$200 million for each of the proposed fiscal years; however the CIP Appendix includes expenditures of \$246 million and \$240 million, respectively, for fiscal years 2017 and 2018. Please explain and correct the discrepancy by increasing the budget number or reducing projects contained in the Appendices. We will have more extensive comments going forward, and in particular, once additional detail is provided as requested in this letter.

We look forward to beginning the budget review process next week and engaging in a productive dialog with our fellow directors.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachment 1: Appellate Court Decision – *Newhall County Water District v. Castaic Lake Water Agency*

Attachment 2: Excerpt from the Board's July 8, 2013 Finance and Insurance Committee Meeting

Attachment 3: MWD Act Sections 124.5 and 134

Attachment 4: Water Authority's November 17, 2014 Letter RE Balancing Accounts

Filed 1/19/16

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION EIGHT

NEWHALL COUNTY WATER
DISTRICT,

Plaintiff and Respondent,

v.

CASTAIC LAKE WATER AGENCY et
al.,

Defendants and Appellants.

B257964

(Los Angeles County
Super. Ct. No. BS142690)

APPEAL from a judgment of the Superior Court for the County of Los Angeles.
James C. Chalfant, Judge. Affirmed.

Best Best & Krieger, Jeffrey V. Dunn, and Kimberly E. Hood for Defendants and
Appellants.

Colantuono, Highsmith & Whatley, Michael G. Colantuono, David J. Ruderman,
Jon R. di Cristina; Lagerlof, Senecal, Gosney & Kruse and Thomas S. Bunn III for
Plaintiff and Respondent.

SUMMARY

Plaintiff Newhall County Water District (Newhall), a retail water purveyor, challenged a wholesale water rate increase adopted in February 2013 by the board of directors of defendant Castaic Lake Water Agency (the Agency), a government entity responsible for providing imported water to the four retail water purveyors in the Santa Clarita Valley. The trial court found the Agency’s rates violated article XIII C of the California Constitution (Proposition 26). Proposition 26 defines any local government levy, charge or exaction as a tax requiring voter approval, unless (as relevant here) it is imposed “for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product.” (Cal. Const., art. XIII C, § 1, subd. (e)(2).)¹

The challenged rates did not comply with this exception, the trial court concluded, because the Agency based its wholesale rate for imported water in substantial part on Newhall’s use of groundwater, which was not supplied by the Agency. Consequently, the wholesale water cost allocated to Newhall did not, as required, “bear a fair or reasonable relationship to [Newhall’s] burdens on, or benefits received from, the [Agency’s] activity.” (Art. XIII C, § 1, subd. (e), final par.)

We affirm the trial court’s judgment.

FACTS

We base our recitation of the facts in substantial part on the trial court’s lucid descriptions of the background facts and circumstances giving rise to this litigation.

1. The Parties

The Agency is a special district and public agency of the state established in 1962 as a wholesale water agency to provide imported water to the water purveyors in the Santa Clarita Valley. It is authorized to acquire water and water rights, and to provide, sell and deliver that water “at wholesale only” for municipal, industrial, domestic and

¹ All further references to any “article” are to the California Constitution.

other purposes. (Wat. Code Appen., § 103-15.) The Agency supplies imported water, purchased primarily from the State Water Project, to four retail water purveyors, including Newhall.

Newhall is also a special district and public agency of the state. Newhall has served its customers for over 60 years, providing treated potable water to communities near Santa Clarita, primarily to single family residences. Newhall owns and operates distribution and transmission mains, reservoirs, booster pump stations, and 11 active groundwater wells.

Two of the other three retail water purveyors are owned or controlled by the Agency: Santa Clarita Water Division (owned and operated by the Agency) and Valencia Water Company (an investor-owned water utility controlled by the Agency since December 21, 2012). Through these two retailers, the Agency supplies about 83 percent of the water demand in the Santa Clarita Valley. The Agency's stated vision is to manage all water sales in the Santa Clarita Valley, both wholesale and retail.

The fourth retailer is Los Angeles County Waterworks District No. 36 (District 36), also a special district and public agency, operated by the County Department of Public Works. It is the smallest retailer, accounting for less than 2 percent of the total water demand.

2. Water Sources

The four retailers obtain the water they supply to consumers from two primary sources, local groundwater and the Agency's imported water.

The only groundwater source is the Santa Clara River Valley Groundwater Basin, East Subbasin (the Basin). The Basin is comprised of two aquifer systems, the Alluvium and the Saugus Formation. This groundwater supply alone cannot sustain the collective demand of the four retailers. (The Basin's operational yield is estimated at 37,500 to 55,000 acre-feet per year (AFY) in normal years, while total demand was projected at 72,343 AFY for 2015, and 121,877 AFY in 2050.)

The groundwater basin, so far as the record shows, is in good operating condition, with no long-term adverse effects from groundwater pumping. Such adverse effects

(known as overdraft) could occur if the amount of water extracted from an aquifer were to exceed the amount of water that recharges the aquifer over an extended period. The retailers have identified cooperative measures to be taken, if needed, to ensure sustained use of the aquifer. These include the continued “conjunctive use” of imported supplemental water and local groundwater supplies, to maximize water supply from the two sources. Diversity of supply is considered a key element of reliable water service during dry years as well as normal and wet years.

In 1997, four wells in the Saugus Formation were found to be contaminated with perchlorate, and in 2002 and 2005, perchlorate was detected in two wells in the Alluvium. All the wells were owned by the retailers, one of them by Newhall. During this period, Newhall and the two largest retailers (now owned or controlled by the Agency) increased their purchases of imported water significantly.

3. Use of Imported Water

Until 1987, Newhall served its customers relying only on its groundwater rights.² Since 1987, it has supplemented its groundwater supplies with imported water from the Agency.

The amount of imported water Newhall purchases fluctuates from year to year. In the years before 1998, Newhall’s water purchases from the Agency averaged 11 percent of its water demand. During the period of perchlorate contamination (1998-2009), its imported water purchases increased to an average of 52 percent of its total demand. Since then, Newhall’s use of imported water dropped to 23 percent, and as of 2012,

² Newhall has appropriative water rights that arise from California’s first-in-time-first-in-right allocation of limited groundwater supplies. (See *El Dorado Irrigation Dist. v. State Water Resources Control Board* (2006) 142 Cal.App.4th 937, 961 [“ ‘[T]he appropriation doctrine confers upon one who actually diverts and uses water the right to do so provided that the water is used for reasonable and beneficial uses and is surplus to that used by riparians or earlier appropriators.’ ”]; *City of Barstow v. Mojave Water Agency* (2000) 23 Cal.4th 1224, 1241 [“ ‘As between appropriators, . . . the one first in time is the first in right, and a prior appropriator is entitled to all the water he needs, up to the amount he has taken in the past, before a subsequent appropriator may take any [citation].’ ”].)

Newhall received about 25 percent of its total water supply from the Agency. The overall average since it began to purchase imported water in 1987, Newhall tells us, is 30 percent.

The other retailers, by contrast, rely more heavily on the Agency's imported water. Agency-owned Santa Clarita Water Division is required by statute to meet at least half of its water demand using imported water. (See Wat. Code Appen., § 103-15.1, subd. (d).) Agency-controlled Valencia Water Company also meets almost half its demand with imported water.

4. The Agency's Related Powers and Duties

As noted above, the Agency's primary source of imported water is the State Water Project. The Agency purchases that water under a contract with the Department of Water Resources. The Agency also acquires water under an acquisition agreement with the Buena Vista Water Storage District and the Rosedale-Rio Bravo Water Storage District, and other water sources include recycled water and water stored through groundwater banking agreements. Among the Agency's powers are the power to "[s]tore and recover water from groundwater basins" (Wat. Code Appen., § 103-15.2, subd. (b)), and "[t]o restrict the use of agency water during any emergency caused by drought, or other threatened or existing water shortage, and to prohibit the wastage of agency water" (§ 103-15, subd. (k)).

In addition, and as pertinent here, the Agency may "[d]evelop groundwater management plans within the agency which may include, without limitation, conservation, overdraft protection plans, and groundwater extraction charge plans" (Wat. Code Appen., § 103-15.2, subd. (c).) The Agency has the power to implement such plans "subject to the rights of property owners and with the approval of the retail water purveyors and other major extractors of over 100 acre-feet of water per year." (*Ibid.*)

In 2001, the Legislature required the Agency to begin preparation of a groundwater management plan, and provided for the formation of an advisory council consisting of representatives from the retail water purveyors and other major extractors.

(Wat. Code Appen., § 103-15.1, subd. (e)(1)&(2)(A).) The Legislature required the Agency to “regularly consult with the council regarding all aspects of the proposed groundwater management plan.” (*Id.*, subd. (e)(2)(A).)

Under this legislative authority, the Agency spearheaded preparation of the 2003 Groundwater Management Plan for the Basin, and more recently the 2010 Santa Clarita Valley Urban Water Management Plan. These plans were approved by the retailers, including Newhall.

The 2003 Groundwater Management Plan states the overall management objectives for the Basin as: (1) development of an integrated surface water, groundwater, and recycled water supply to meet existing and projected demands for municipal, agricultural and other water uses; (2) assessment of groundwater basin conditions “to determine a range of operational yield values that will make use of local groundwater conjunctively with [State Water Project] and recycled water to avoid groundwater overdraft”; (3) preservation of groundwater quality; and (4) preservation of interrelated surface water resources. The 2010 Santa Clarita Valley Urban Water Management Plan, as the trial court described it, is “an area-wide management planning tool that promotes active management of urban water demands and efficient water usage by looking to long-range planning to ensure adequate water supplies to serve existing customers and future demands”

5. The Agency’s Wholesale Water Rates

The board of directors of the Agency fixes its water rates, “so far as practicable, [to] result in revenues that will pay the operating expenses of the agency, . . . provide for the payment of the cost of water received by the agency under the State Water Plan, provide for repairs and depreciation of works, provide a reasonable surplus for improvements, extensions, and enlargements, pay the interest on any bonded debt, and provide a sinking or other fund for the payment of the principal of that bonded debt” (Wat. Code Appen., § 103-24, subd. (a).) The Agency’s operating costs include costs for management, administration, engineering, maintenance, water quality compliance, water resources, water treatment operations, storage and recovery programs, and studies.

Before the rate changes at issue here, the Agency had a “100 percent variable” rate structure. That means it charged on a per acre-foot basis for the imported water sold, known as a “volumetric” rate. Thus, as of January 1, 2012, retailers were charged \$487 per acre-foot of imported water, plus a \$20 per acre-foot charge for reserve funding.

Because of fluctuations in the demand for imported water (such as during the perchlorate contamination period), the Agency’s volumetric rates result in fluctuating, unstable revenues. The Agency engaged consultants to perform a comprehensive wholesale water rate study, and provide recommendations on rate structure options. The objective was a rate structure that would provide revenue sufficiency and stability to the Agency, provide cost equity and certainty to the retailers, and enhance conjunctive use of the sources of water supply and encourage conservation. As the Agency’s consultants put it, “[t]wo of the primary objectives of cost of service water rates are to ensure the utility has sufficient revenue to cover the costs of operating and maintaining the utility in a manner that will ensure long term sustainability and to ensure that costs are recovered from customers in a way that reflects the demands they place on the system.”

The general idea was a rate structure with both volumetric and fixed components. Wholesale rate structures that include both a fixed charge component (usually calculated to recover all or a portion of the agency’s fixed costs of operating, maintaining and delivering water) and a volumetric component (generally calculated based on the cost of purchased water, and sometimes including some of the fixed costs) are common in the industry.

6. The Challenged Rates

The Agency’s consultants presented several rate structure options. In the end, the option the Agency chose (the challenged rates) consisted of two components. The first component is a fixed charge based on each retailer’s three-year rolling average of total water demand (that is, its demand for the Agency’s imported water *and* for groundwater not supplied by the Agency). This fixed charge is calculated by “divid[ing] the Agency’s total fixed revenue for the applicable fiscal year . . . by the previous three-year average of total water demand of the applicable Retail Purveyor to arrive at a unit cost per acre

foot.” The Agency would recover 80 percent of its costs through the fixed component of the challenged rates. The second component of the Agency’s rate is a variable charge, based on a per acre foot charge for imported water.³

The rationale for recovering the Agency’s fixed costs in proportion to the retailers’ total water demand, rather than their demand for imported water, is this (as described in the consultants’ study):

“This rate structure meets the Agency’s objective of promoting resource optimization, conjunctive use, and water conservation. Since the fixed cost is allocated on the basis of each retail purveyor’s total demand, if a retail purveyor conserves water, then its fixed charge will be reduced. Additionally, allocating the fixed costs based on total water demand recognizes that imported water is an important standby supply that is available to all retail purveyors, and is also a necessary supply to meet future water demand in the region, and that there is a direct nexus between groundwater availability and imported water use – i.e., it allocates the costs in a manner that bears a fair and reasonable relationship to the retail purveyors’ burdens on and benefits from the Agency’s activities in ensuring that there is sufficient water to meet the demands of all of the retail purveyors and that the supply sources are responsibly managed for the benefits of all of the retail purveyors.”

The rationale continues: “Moreover, the Agency has taken a leadership role in maintaining the health of the local groundwater basin by diversifying the Santa Clarita Valley’s water supply portfolio, as demonstrated in the 2003 Groundwater Management Plan and in resolving perchlorate contamination of the Saugus Formation aquifer. Thus, since all retail purveyors benefit from imported water and the Agency’s activities, they should pay for the reasonable fixed costs of the system in proportion to the demand (i.e.

³ There was also a \$20 per acre foot reserve charge to fund the Agency’s operating reserves, but the Agency reports in its opening brief that it suspended implementation of that charge as of July 1, 2013, when reserve fund goals were met earlier than anticipated.

burdens) they put on the total water supply regardless of how they utilize individual sources of supply.”

The Agency’s rate study showed that, during the first year of the challenged rates (starting July 1, 2013), Newhall would experience a 67 percent increase in Agency charges, while Agency controlled retailers Valencia Water Company and Santa Clarita Water Division would see reductions of 1.9 percent and 10 percent, respectively. District 36 would have a 0.8 percent increase. The rate study also indicated that, by 2050, the impact of the challenged rates on Newhall was expected to be less than under the then-current rate structure, while Valencia Water Company was expected to pay more.

Newhall opposed the challenged rates during the ratemaking process. Its consultant concluded the proposed structure was not consistent with industry standards; would provide a nonproportional, cross-subsidization of other retailers; and did not fairly or reasonably reflect the Agency’s costs to serve Newhall. Newhall contended the rates violated the California Constitution and other California law. It proposed a rate structure that would base the Agency’s fixed charge calculation on the annual demand for imported water placed on the Agency by each of its four customers, using a three-year rolling average of past water deliveries to each retailer.

In February 2013, the Agency’s board of directors adopted the challenged rates, effective July 1, 2013.

7. This Litigation

Newhall sought a writ of mandate directing the Agency to rescind the rates, to refund payments made under protest, to refrain from charging Newhall for its imported water service “with respect to the volume of groundwater Newhall uses or other services [the Agency] does not provide Newhall,” and to adopt a new, lawful rate structure. Newhall contended the rates were not proportionate to Newhall’s benefits from, and burdens on, the Agency’s service, and were therefore invalid under Proposition 26, Proposition 13, Government Code section 54999.7, and the common law of utility ratemaking.

The trial court granted Newhall’s petition, finding the rates violated Proposition 26. The court concluded the Agency had no authority to impose rates based on the use of groundwater that the Agency does not provide, and that conversely, Newhall’s use of its groundwater rights does not burden the Agency’s system for delivery of imported water. Thus the rates bore no reasonable relationship to Newhall’s burden on, or benefit received from, the Agency’s service. The trial court also found the rates violated Government Code section 54999.7 (providing that a fee for public utility service “shall not exceed the reasonable cost of providing the public utility service” (Gov. Code, § 54999.7, subd. (a)), and violated common law requiring utility charges to be fair, reasonable and proportionate to benefits received by ratepayers. The court ordered the Agency to revert to the rates previously in effect until the adoption of new lawful rates, and ordered it to refund to Newhall the difference between the monies paid under the challenged rates and the monies that would have been paid under the previous rates.

Judgment was entered on July 28, 2014, and the Agency filed a timely notice of appeal.

DISCUSSION

The controlling issue in this case is whether the challenged rates are a tax or a fee under Proposition 26.

1. The Standard of Review

We review de novo the question whether the challenged rates comply with constitutional requirements. (*Griffith v. City of Santa Cruz* (2012) 207 Cal.App.4th 982, 989-990 (*Griffith I*.) We review the trial court’s resolution of factual conflicts for substantial evidence. (*Morgan v. Imperial Irrigation District* (2014) 223 Cal.App.4th 892, 916.)

2. The Governing Principles

All taxes imposed by any local government are subject to voter approval. (Art. XIII C, § 2.) Proposition 26, adopted in 2010, expanded the definition of a tax. A “tax” now includes “any levy, charge, or exaction of any kind imposed by a local government,”

with seven exceptions. (*Id.*, § 1, subd. (e).) This case concerns one of those seven exceptions.

Under Proposition 26, the challenged rates are not a tax, and are not subject to voter approval, if they are “[a] charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product.” (Art. XIII C, § 1, subd. (e)(2).) The Agency “bears the burden of proving by a preponderance of the evidence” that its charge “is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor’s burdens on, or benefits received from, the governmental activity.” (*Id.*, subd. (e), final par.)

3. This Case

It is undisputed that the Agency’s challenged rates are designed “to recover all of its fixed costs via a fixed charge,” and not to generate surplus revenue. Indeed, Newhall recognizes the Agency’s right to impose a fixed water-rate component to recover its fixed costs. The dispute here is whether the fixed rate component may be based in significant part on the purchaser’s use of a product – groundwater – not provided by the Agency.

We conclude the Agency cannot, consistent with Proposition 26, base its wholesale water rates on the retailers’ use of groundwater, because the Agency does not supply groundwater. Indeed, the Agency does not even have the statutory authority to regulate groundwater, without the consent of the retailers (and other major groundwater extractors). As a consequence, basing its water rates on groundwater it does not provide violates Proposition 26 on two fronts.

First, the rates violate Proposition 26 because the method of allocation does not “bear a fair or reasonable relationship to the payor’s burdens on, or benefits received from,” the Agency’s activity. (Art. XIII C, § 1, subd. (e), final par.) (We will refer to this as the reasonable cost allocation or proportionality requirement.)

Second, to the extent the Agency relies on its groundwater management activities to justify including groundwater use in its rate structure, the benefit to the retailers from those activities is at best indirect. Groundwater management activities are not a “service . . . provided directly to the payor that is not provided to those not charged” (art. XIII C, § 1, subd. (e)(2)), but rather activities that benefit the Basin as a whole, including other major groundwater extractors that are not charged for those services.

For both these reasons, the challenged rates cannot survive scrutiny under Proposition 26. The Agency resists this straightforward conclusion, proffering two principal arguments, melded together. The first is that the proportionality requirement is measured “collectively,” not by the burdens on or benefits received by the individual purveyor. The second is that the “government service or product” the Agency provides to the four water retailers consists not just of providing wholesale water, but also of “managing the Basin water supply,” including “management . . . of the Basin’s groundwater.” These responsibilities, the Agency argues, make it reasonable to set rates for its wholesale water service by “tak[ing] into account the entire Valley water supply portfolio and collective purveyor-benefits of promoting conjunctive use, not just the actual amount of Agency imported water purchased by each Purveyor”

Neither claim has merit, and the authorities the Agency cites do not support its contentions.

a. *Griffin I* and the proportionality requirement

It seems plain to us, as it did to the trial court, that the demand for a product the Agency does not supply – groundwater – cannot form the basis for a reasonable cost allocation method: one that is constitutionally required to be proportional to the benefits the rate payor receives from (or the burden it places on) the Agency’s activity. The Agency’s contention that it may include the demand for groundwater in its rate structure because the proportionality requirement is measured “collectively,” not by the burdens on or benefits to the individual retail purveyor, is not supported by any pertinent authority.

In contending otherwise, the Agency relies on, but misunderstands, *Griffith I* and other cases stating that proportionality “ ‘is not measured on an individual basis,’ ” but

rather “ ‘collectively, considering all rate payors,’ ” and “ ‘need not be finely calibrated to the precise benefit each individual fee payor might derive.’ ” (*Griffith I, supra*, 207 Cal.App.4th at p. 997, quoting *California Farm Bureau Federation v. State Water Resources Control Bd.* (2011) 51 Cal.4th 421, 438 [discussing regulatory fees under the Water Code and Proposition 13].) As discussed *post*, these cases do not apply here, for one or more reasons. *Griffith I* involves a different exemption from Proposition 26, and other cases involve Proposition 218, which predated Proposition 26 and has no direct application here. In addition to these distinctions – which do make a difference – the cases involved large numbers of payors, who could rationally be (and were) placed in different usage categories, justifying different fees for different classes of payors.

In *Griffith I*, the defendant city imposed an annual inspection fee for all residential rental properties in the city. The court rejected a claim that the inspection fee was a tax requiring voter approval under Proposition 26. (*Griffith I, supra*, 207 Cal.App.4th at p. 987.) *Griffith I* involves another of the seven exemptions in Proposition 26, the exemption for regulatory fees – charges imposed for the regulatory costs of issuing licenses, performing inspections, and the like. (Art. XIII C, § 1, subd. (e)(3) [expressly excepting, from the “tax” definition, a “charge imposed for the reasonable regulatory costs to a local government for . . . performing inspections”].)

The inspection fees in *Griffith I* met all the requirements of Proposition 26. The city’s evidence showed the fees did not exceed the approximate cost of the inspections. (*Griffith I, supra*, 207 Cal.App.4th at p. 997.) And the proportionality requirement of Proposition 26 was also met: “The fee schedule itself show[ed] the basis for the apportionment,” setting an annual registration fee plus a \$20 per unit fee, with lower fees for “[s]elf-certifications” that cost the city less to administer, and greater amounts charged when reinspections were required. (*Griffith I*, at p. 997.) The court concluded: “Considered collectively, the fees are reasonably related to the payors’ burden upon the inspection program. *The larger fees are imposed upon those whose properties require the most work.*” (*Ibid.*, italics added.)

Griffith I did, as the Agency tells us, state that “ ‘the question of proportionality is not measured on an individual basis’ ” but rather “ ‘collectively, considering all rate payors.’ ” (*Griffith I, supra*, 207 Cal.App.4th at p. 997.) But, as mentioned, *Griffith I* was considering a regulatory fee, not, as here, a charge imposed on four ratepayers for a “specific government service or product.” As *Griffith I* explained, “ ‘[t]he scope of a regulatory fee is somewhat flexible’ ” and “ ‘must be related to the overall cost of the governmental regulation,’ ” but “ ‘need not be finely calibrated to the precise benefit each individual fee payor might derive.’ ” (*Ibid.*) That, of course, makes perfect sense in the context of a regulatory fee applicable to numerous payors; indeed, it would be impossible to assess such fees based on the individual payor’s precise burden on the regulatory program. But the inspection fees *were* allocated by categories of payor, and were based on the burden on the inspection program, with higher fees where more city work was required.

Here, there are four payors, with no need to group them in classes to allocate costs. The *Griffith I* concept of measuring proportionality “collectively” simply does not apply. Where charges for a government service or product are to be allocated among only four payors, the only rational method of evaluating their burdens on, or benefits received from, the governmental activity, is individually, payor by payor. And that is particularly appropriate considering the nature of the Proposition 26 exemption in question: charges for a product or service that is (and is required to be) provided “directly to the payor.” Under these circumstances, allocation of costs “collectively,” when the product is provided directly to each of the four payors, cannot be, and is not, a “fair or reasonable” allocation method. (Art. XIII C, § 1, subd. (e), final par.)

b. *Griffith II* – the proportionality requirement and related claims

In *Griffith v. Pajaro Valley Water Management Agency* (2013) 220 Cal.App.4th 586 (*Griffith II*), the court concluded, among other things, that a groundwater augmentation charge complied with the proportionality requirement of Proposition 218. The Agency relies on *Griffith II*, asserting that the court applied the “concept of collective reasonableness with respect to rate allocations” Further, the case

demonstrates, the Agency tells us, that its activities in “management . . . of the Basin’s groundwater” justify basing its rates on total water demand, because all four retailers benefit from having the Agency’s imported water available, even when they do not use it. Neither claim withstands analysis.

Griffith II involved a challenge under Proposition 218, so we pause to describe its relevant points. Proposition 218 contains various procedural (notice, hearing, and voting) requirements for the imposition by local governments of fees and charges “upon a parcel or upon a person as an incident of property ownership, including a user fee or charge for a property related service.” (Art. XIII D, § 2, subd. (e).) Fees or charges for water service (at issue in *Griffith II*) are exempt from voter approval (art. XIII D, § 6, subd. (c)), but substantive requirements apply. These include a proportionality requirement: that the amount of a fee or charge imposed on any parcel or person “shall not exceed the proportional cost of the service attributable to the parcel.” (*Id.*, subd. (b)(3).)

In *Griffith II*, the plaintiffs challenged charges imposed by the defendant water management agency on the extraction of groundwater (called a “groundwater augmentation charge”). The defendant agency had been created to deal with the issue of groundwater being extracted faster than it is replenished by natural forces, leading to saltwater intrusion into the groundwater basin. (*Griffith II, supra*, 220 Cal.App.4th at p. 590.) The defendant agency was specifically empowered to levy groundwater augmentation charges on the extraction of groundwater from all extraction facilities, “ “for the purposes of paying the costs of purchasing, capturing, storing, and distributing supplemental water for use within [defendant’s boundaries].” ’ ” (*Id.* at p. 591.) The defendant’s strategy to do so had several facets, but its purpose was to reduce the amount of water taken from the groundwater basin by supplying water to some coastal users, with the cost borne by all users, “on the theory that even those taking water from [inland] wells benefit from the delivery of water to [coastal users], as that reduces the amount of groundwater those [coastal users] will extract [from their own wells], thereby keeping the water in [all] wells from becoming too salty.’ ” (*Id.* at pp. 590-591.)

Griffith II found the charge complied with the Proposition 218 requirement that the charge could not exceed the proportional costs of the service attributable to the parcel. (*Griffith II, supra*, 220 Cal.App.4th at pp. 600-601.) Proposition 218, the court concluded, did not require “a parcel-by-parcel proportionality analysis.” (*Griffith II*, at p. 601.) The court found defendant’s “method of grouping similar users together for the same augmentation rate and charging the users according to usage is a reasonable way to apportion the cost of service,” and Proposition 218 “does not require a more finely calibrated apportion.” (*Griffith II*, at p. 601.) The augmentation charge “affects those on whom it is imposed by burdening them with an expense they will bear proportionately to the amount of groundwater they extract at a rate depending on which of three rate classes applies. It is imposed ‘across-the-board’ on all water extractors. All persons extracting water – including any coastal users who choose to do so – will pay an augmentation charge per acre-foot extracted. All persons extracting water and paying the charge will benefit in the continued availability of usable groundwater.” (*Griffith II*, at pp. 603-604.)

The court rejected the plaintiffs’ claim the charge for groundwater extraction on their parcels was disproportionate because they did not use the agency’s services – that is, they did not receive delivered water, as coastal landowners did. This claim, the court said, was based on the erroneous premise that the agency’s only service was to deliver water to coastal landowners. The court pointed out that the defendant agency was created to manage the water resources for the common benefit of all water users, and the groundwater augmentation charge paid for the activities required to prepare and implement the groundwater management program. (*Griffith II, supra*, 220 Cal.App.4th at p. 600.) Further, the defendant agency “apportioned the augmentation charge among different categories of users (metered wells, unmetered wells, and wells within the delivered water zone).” (*Id.* at p. 601.) (The charges were highest for metered wells in the coastal zone, and there was also a per acre-foot charge for delivered water. (*Id.* at p. 593 & fn. 4.))

We see nothing in *Griffith II* that assists the Agency here. The Agency focuses on the fact that the defendant charged the plaintiff for groundwater extraction even though

the plaintiff received no delivered water, and on the court's statement that the defendant was created to manage water resources for the common benefit of all water users. (*Griffith II, supra*, 220 Cal.App.4th at p. 600.) From this the Agency leaps to the erroneous conclusion that the rates here satisfy the proportionality requirement simply because all four retailers "benefit from having the Agency's supplemental water supplies available," even when they do not use them. This is a false analogy. In *Griffith II*, the defendant charged all groundwater extractors proportionately for extracting water (and had the power to do so), and charged for delivered water as well. *Griffith II* does not support the imposition of charges based on a product the Agency does not supply.

We note further that in *Griffith II*, more than 1,900 parcel owners were subject to the groundwater augmentation charge, and they were placed in three different classes of water extractors and charged accordingly. (*Griffith II, supra*, 220 Cal.App.4th at pp. 593, 601.) Here, there are four water retailers receiving the Agency's wholesale water service, none of whom can reasonably be placed in a different class or category from the other three. In these circumstances, to say costs may be allocated to the four purveyors "collectively," based in significant part on groundwater not supplied by the Agency, because "they all benefit" from the availability of supplemental water supplies, would effectively remove the proportionality requirement from Proposition 26.

That we may not do. Proposition 26 requires by its terms an allocation method that bears a reasonable relationship to the payor's burdens on or benefits from the Agency's activity, which here consists of wholesale water service to be provided "directly to the payor." In the context of wholesale water rates to four water agencies, this necessarily requires evaluation on a "purveyor by purveyor" basis. (Cf. *Capistrano Taxpayers Assn., Inc. v. City of San Juan Capistrano* (2015) 235 Cal.App.4th 1493, 1514 (*Capistrano*) ["[w]hen read in context, *Griffith [II]* does not excuse water agencies from ascertaining the true costs of supplying water to various tiers of usage"; *Griffith II*'s "comments on proportionality necessarily relate only to variations in property location"; "trying to apply [*Griffith II*] to the [Proposition 218 proportionality] issue[] is fatally flawed".])

The Agency's claim that it is not charging the retailers for groundwater use, and its attempt to support basing its rates on total water demand by likening itself to the defendant agency in *Griffith II*, both fail as well. The first defies reason. Because the rates are based on total water demand, the more groundwater a retailer uses, the more it pays under the challenged rates. The use of groundwater demand in the rate structure necessarily means that, in effect, the Agency is charging for groundwater use.

The second assertion is equally mistaken. The differences between the Agency and the defendant in *Griffith II* are patent. In *Griffith II*, the defendant agency was created to manage all water resources, and specifically to deal with saltwater intrusion into the groundwater basin. The Agency here was not. It was created to acquire water and to "provide, sell, and deliver" it. It is authorized to develop and implement groundwater management plans only with the approval of the retail water purveyors (and other major groundwater extractors). In other words, while the Agency functions as the lead agency in developing and coordinating groundwater management plans, its only authority over groundwater, as the trial court found, is a shared responsibility to develop those plans. Further, in *Griffith II*, the defendant agency was specifically empowered to levy groundwater extraction charges for the purpose of purchasing supplemental water. The Agency here was not. As the trial court here aptly concluded, *Griffith II* "does not aid [the Agency] for the simple reason that [the Agency] has no comprehensive authority to manage the water resources of the local groundwater basin and levy charges related to groundwater."⁴

Finally, the Agency insists that it "must be allowed to re-coup its cost of service," and that the practice of setting rates to recover fixed expenses, "irrespective of a customer's actual consumption," was approved in *Paland v. Brooktrails Township*

⁴ The trial court also observed that, "[a]part from [the Agency's] lack of authority to supply or manage Basin groundwater, Newhall correctly notes that [the Agency] has presented no evidence of its costs in maintaining the Basin."

Community Services Dist. Bd. of Directors (2009) 179 Cal.App.4th 1358 (*Paland*).
Paland has no application here.

Paland involved Proposition 218. As we have discussed, Proposition 218 governs (among other things) “property related fees and charges” on parcels of property. Among its prohibitions is any fee or charge for a service “unless that service is actually used by, or immediately available to, the owner of the property in question.” (Art. XIII D, § 6, subd. (b)(4).) The court held that a minimum charge, imposed on parcels of property with connections to the district’s utility systems, for the basic cost of providing water service, regardless of actual use, was “a charge for an immediately available property-related water or sewer service” within the meaning of Proposition 218, and not an assessment requiring voter approval. (*Paland, supra*, 179 Cal.App.4th at p. 1362; see *id.* at p. 1371 [“Common sense dictates that continuous maintenance and operation of the water and sewer systems is necessary to keep those systems immediately available to inactive connections like [the plaintiff’s].”].)

We see no pertinent analogy between *Paland* and this case. This case does not involve a minimum charge imposed on all parcels of property (or a minimum charge for standing ready to supply imported water). Newhall does not contest the Agency’s right to charge for its costs of standing ready to provide supplemental water, and to recoup all its fixed costs. The question is whether the Agency may recoup those costs using a cost allocation method founded on the demand for groundwater the Agency does not supply, and is not empowered to regulate without the consent of groundwater extractors. The answer under Proposition 26 is clear: it may not. *Paland* does not suggest otherwise.⁵

⁵ The parties refer to other recent authorities to support their positions in this case. We may not rely on one of them, because the Supreme Court has granted a petition for review. (*City of San Buenaventura v. United Water Conservation District* (2015) 235 Cal.App.4th 228, review granted June 24, 2015, S226036.) The Agency cites the other case extensively in its reply brief, but we see nothing in that case to suggest that the challenged rates here comply with Proposition 26. (*Great Oaks Water Co. v. Santa Clara Valley Water District* 242 Cal.App.4th 1187 (*Great Oaks*).)

c. Other claims – conservation and “conjunctive use”

The Agency attempts to justify the challenged rates by relying on the conservation mandate in the California Constitution, pointing out it has a constitutional obligation to encourage water conservation. (Art. X, § 2 [declaring the state’s water resources must “be put to beneficial use to the fullest extent of which they are capable, and that the waste or unreasonable use or unreasonable method of use of water [must] be prevented”].) The challenged rates comply with this mandate, the Agency contends, because reducing total water consumption will result in lower charges, and the rates encourage “a coordinated use of groundwater and supplemental water” (conjunctive use). This argument, too, misses the mark.

The Agency’s brief fails to describe the circumstances in *Great Oaks*. There, a water retailer challenged a groundwater extraction fee imposed by the defendant water district. Unlike this case, the defendant in *Great Oaks* was authorized by statute to impose such fees, and its major responsibilities included “preventing depletion of the aquifers from which [the water retailer] extracts the water it sells.” (*Great Oaks, supra*, 242 Cal.App.4th at p. 1197.) The Court of Appeal, reversing a judgment for the plaintiff, held (among other things) that the fee was a property-related charge, and therefore subject to some of the constraints of Proposition 218, but was also a charge for water service, and thus exempt from the requirement of voter ratification. (*Great Oaks*, at p. 1197.) The trial court’s ruling in *Great Oaks* did not address the plaintiff’s contentions that the groundwater extraction charge violated three substantive limitations of Proposition 218, and the Court of Appeal ruled that one of those contentions (that the defendant charged more than was required to provide the property related service on which the charge was predicated) could be revisited on remand. The others were not preserved in the plaintiff’s presuit claim, so no monetary relief could be predicated on those theories. (*Great Oaks*, at pp. 1224, 1232-1234.)

The Agency cites *Great Oaks* repeatedly, principally for the statements that the “provision of alternative supplies of water serves the long-term interests of extractors by reducing demands on the groundwater basin and helping to prevent its depletion,” and that it was not irrational for the defendant water district “to conclude that reduced demands on groundwater supplies benefit retailers by preserving the commodity on which their long-term viability, if not survival, may depend.” (*Great Oaks, supra*, 242 Cal.App.4th at pp. 1248-1249.) These statements, with which we do not disagree, have no bearing on this case, and were made in connection with the court’s holding that the trial court erred in finding the groundwater extraction charge violated the statute that created and empowered the defendant water district. (*Id.* at pp. 1252-1253.)

Certainly the Agency may structure its rates to encourage conservation of the imported water it supplies. (Wat. Code, § 375, subd. (a) [public entities supplying water at wholesale or retail may “adopt and enforce a water conservation program to reduce the quantity of water used by [its customers] for the purpose of conserving the water supplies of the public entity”]. But the Agency has no authority to set rates to encourage conservation of groundwater it does not supply. Moreover, article X’s conservation mandate cannot be read to eliminate Proposition 26’s proportionality requirement. (See *City of Palmdale v. Palmdale Water District* (2011) 198 Cal.App.4th 926, 936-937 [“California Constitution, article X, section 2 is not at odds with article XIII D [Proposition 218] so long as, for example, conservation is attained in a manner that ‘shall not exceed the proportional cost of the service attributable to the parcel.’ ”]; see *id.* at p. 928 [district failed to prove its water rate structure complied with the proportionality requirement of Proposition 218]; see also *Capistrano, supra*, 235 Cal.App.4th at p. 1511, quoting *City of Palmdale* with approval.)

The Agency also insists that basing its rates only on the demand for the imported water it actually supplies – as has long been the case – would “discourage users from employing conjunctive use” The Agency does not explain how this is so, and we are constrained to note that, according to the Agency’s own 2003 Groundwater Management Plan, Newhall and the other retailers “have been practicing the conjunctive use of imported surface water and local groundwater” for many years. And, according to that plan, the Agency and retailers have “a historical and ongoing working relationship . . . to manage water supplies to effectively meet water demands within the available yields of imported surface water and local groundwater.”

In connection, we assume, with its conjunctive use rationale, the Agency filed a request for judicial notice, along with its reply brief. It asked us to take notice of three documents and “the facts therein concerning imported water use and local groundwater production” by Newhall and the other water retailers. The documents are the 2014 and 2015 Water Quality Reports for the Santa Clarita Valley, and a water supply utilization table from the 2014 Santa Clarita Valley Water Report published in June 2015. All of

these, the Agency tells us, are records prepared by the Agency and the four retailers, after the administrative record in this case was prepared. The documents “provide further support” as to the “cooperative efforts of the Agency and the Purveyors in satisfying long-term water supply needs,” and “provide context and useful background to aid in the Court’s understanding of this case.” The Agency refers to these documents in its reply brief, pointing out that since 2011, Newhall has increased its imported water purchases because of the impact of the current drought on certain of its wells, while retailer Valencia Water Company increased groundwater pumping and purchased less imported water in 2014. These cooperative efforts, the Agency says, “reflect the direct benefit to Newhall of having an imported water supply available to it, whether or not it maximizes use of imported water in a particular year.”

We deny the Agency’s request for judicial notice. We see no reason to depart from the general rule that courts may not consider evidence not contained in the administrative record. (*Western States Petroleum Assn. v. Superior Court* (1995) 9 Cal.4th 559, 564; cf. *id.* at p. 578 [the exception to the rule in administrative proceedings, for evidence that could not have been produced at the hearing through the exercise of reasonable diligence, applies in “rare instances” where the evidence in question existed at the time of the decision, or in other “unusual circumstances”].) Denial is particularly appropriate where judicial notice has been requested in support of a reply brief to which the opposing party has no opportunity to respond, and where the material is, as the Agency admits, “further support” of evidence in the record, providing “context and useful background.” These are not unusual circumstances.

Returning to the point, neither conservation mandates nor the Agency’s desire to promote conjunctive use – an objective apparently shared by the retailers – permits the Agency to charge rates that do not comply with Proposition 26 requirements. Using demand for groundwater the agency does not supply to allocate its fixed costs may “satisf[y] the Agency’s constitutional obligations . . . to encourage water conservation,”

but it does not satisfy Proposition 26, and it therefore cannot stand.⁶ (Cf. *Capistrano*, *supra*, 235 Cal.App.4th at pp. 1511, 1498 [conservation is to be attained in a manner not exceeding the proportional cost of service attributable to the parcel under Proposition 218; the agency failed to show its tiered rates complied with that requirement].)

d. Other Proposition 26 requirements

We have focused on the failure of the challenged rates to comply with the proportionality requirement of Proposition 26. But the rates do not withstand scrutiny for another reason as well. Proposition 26 exempts the Agency’s charges from voter approval only if the charge is imposed “for a specific government service or product provided *directly* to the payor that is *not* provided to those not charged” (Italics added.) The only “specific government service or product” the Agency provides directly to the retailers, and not to others, is imported water. As the trial court found: the Agency “does not provide Newhall groundwater. It does not maintain or recharge aquifers. It does not help Newhall pump groundwater. Nor does it otherwise contribute directly to the natural recharge of the groundwater Newhall obtains from its wells.”

The groundwater management activities the Agency *does* provide – such as its leadership role in creating groundwater management plans and its perchlorate remediation efforts – are not specific services the Agency provides directly to the retailers, and not to other groundwater extractors in the Basin. On the contrary, groundwater management services redound to the benefit of all groundwater extractors in the Basin – not just the four retailers. Indeed, implementation of any groundwater

⁶ The Agency also cites *Brydon v. East Bay Municipal Utility District* (1994) 24 Cal.App.4th 178 for the principle that, in pursuing a constitutionally and statutorily mandated conservation program, “cost allocations . . . are to be judged by a standard of reasonableness with some flexibility permitted to account for system-wide complexity.” (*Id.* at p. 193.) But *Brydon* predated both Proposition 218 and Proposition 26. (See *Capistrano*, *supra*, 235 Cal.App.4th at pp. 1512-1513 [*Brydon* “simply has no application to post-Proposition 218 cases”; “it seems safe to say that *Brydon* itself was part of the general case law which the enactors of Proposition 218 wanted replaced with stricter controls on local government discretion”].)

management plan is “subject to the rights of property owners and with the approval of the retail water purveyors *and other major extractors* of over 100 acre-feet of water per year.” (Wat. Code Appen., § 103-15.2, subs. (b)&(c), italics added.)

Certainly the Agency may recover through its water rates its entire cost of service – that is undisputed. The only question is whether those costs may be allocated, consistent with Proposition 26, based in substantial part on groundwater use. They may not, because the Agency’s groundwater management activities plainly are not a service “that is not provided to those not charged” (Art. XIII C, § 1, subd. (e)(2).)

In light of our conclusion the challenged rates violate Proposition 26, we need not consider the Agency’s contention that the rates comply with Government Code section 54999.7 and the common law. Nor need we consider the propriety of the remedy the trial court granted, as the Agency raises no claim of error on that point.

DISPOSITION

The judgment is affirmed. Plaintiff shall recover its costs on appeal.

GRIMES, J.

WE CONCUR:

BIGELOW, P. J.

FLIER, J.

Transcription

Keith Lewinger (Director, San Diego County Water Authority)
Tom DeBacker (Controller, Metropolitan Water District of Southern California)

3b: Financial highlights

Finance and Insurance Committee Meeting

July 8, 2013

DeBacker (16:53): That was not based on a percentage. There was a point in time when we did use a percentage and that percentage was about 20 percent of the CIP. When we changed from that practice we went to a 95 million dollars and that was just to kind of, you know, get us close to what a 20 percent amount would be, but it was not precisely 20 percent.

Lewinger: So it was meant to represent approximately 20 percent?

DeBacker: Yeah and I was just using that going forward.

The Metropolitan Water District Act

PREFACE

This volume constitutes an annotated version of the Metropolitan Water District Act, as reenacted by the California State Legislature in 1969 and as amended in 1970, 1971, 1972, 1973, 1974, 1975, 1976, 1978, 1981, 1984, 1985, 1995, 1998, 1999, 2001, 2004, and **2008**. Where there is no legislative history given for a section of this act, it is because the section was enacted as part of the nonsubstantive revision of the Metropolitan Water District Act, Statutes 1969, chapter 209. The editorial work was done by the office of the General Counsel of The Metropolitan Water District of Southern California. To facilitate use of the act, catchlines or catchwords enclosed by brackets have been inserted to indicate the nature of the sections which follow. Also, a table of contents has been set at the beginning of the act. Such table of contents and catchlines or catchwords are not a part of the act as enacted by the Legislature. This annotated act will be kept up to date by means of supplemental pages issued each year in which there is a change to the act.

**(Statutes 1969, ch.209, as amended;
West's California Water Code – Appendix Section 109
Deering's California Water Code – Uncodified Act 570)**

A contract between the State and a metropolitan water district for a water supply from the State Water Resources Development System was a contract for the furnishing of continued water service in the future, payments by the district being contingent upon performance of contractual duties by the State and not incurred at the outset, so the district did not incur an indebtedness in excess of that permitted by former Section 5(7) of the Metropolitan Water District Act (now Sec. 123).

Metropolitan Water District v. Marquardt, 59 Cal.2d 159, 28 Cal. Rptr. 724 (1963).

Sec. 124. [Taxes, Levy and Limitation]

A district may levy and collect taxes on all property within the district for the purposes of carrying on the operations and paying the obligations of the district, except that such taxes, exclusive of any tax levied to meet the bonded indebtedness of such district and the interest thereon, exclusive of any tax levied to meet any obligation to the United States of America or to any board, department or agency thereof, and exclusive of any tax levied to meet any obligation to the state pursuant to Section 11652 of the Water Code, shall not exceed five cents (\$0.05) on each such one hundred dollars (\$100) of assessed valuation. The term "tax levied to meet the bonded indebtedness of such district and the interest thereon" as used in this section shall also include, but shall not be limited to, any tax levied pursuant to Section 287 to pay the principal of, or interest on, bond anticipation notes and any tax levied under the provisions of any resolution or ordinance providing for the issuance of bonds of the district to pay, as the same shall become due, the principal of any term bonds which under the provisions of such resolution or ordinance are to be paid and retired by call or purchase before maturity with moneys set aside for that purpose.

Amended by Stats. 1969, ch. 441.

CASE NOTE

An article in a contract between the State and a metropolitan water district for a water supply from the State Water Resources Development System which article is based upon Water Code Section 11652, requiring the district to levy a tax to provide for all payments due under the contract, does not contravene former Section 5(8) of the Metropolitan Water District Act, imposing a limit on taxation, as Section 11652 is a special provision relating only to taxation to meet obligations from water contracts with state agencies, whereas said Section 5(8) is a general provision relating to taxation by a district for all purposes and the special provision controls the general provision.

Metropolitan Water District v. Marquardt, 59 Cal.2d 159, 28 Cal. Rptr. 724 (1963).

Sec. 124.5. [Ad valorem Tax Limitation]

Subject only to the exception in this section and notwithstanding any other provision of law, commencing with the 1990-91 fiscal year any ad valorem property tax levied by a district on taxable property in the district, other than special taxes levied and collected pursuant to annexation proceedings pursuant to Articles 1 (commencing with Section 350), 2 (commencing with Section 360), 3 (commencing with Section 370), and 6 (commencing with Section 405) of Chapter 1 of Part 7, shall not exceed the composite amount required to pay (1) the principal and interest on general obligation bonded indebtedness of the district and (2) that portion of the district's payment obligation under a water service contract with the state which is reasonably

allocable, as determined by the district, to the payment by the state of principal and interest on bonds issued pursuant to the California Water Resources Development Bond Act as of the effective date of this section and used to finance construction of facilities for the benefit of the district. The restrictions contained in this section do not apply if the board of directors of the district, following a hearing held to consider that issue, finds that a tax in excess of these restrictions is essential to the fiscal integrity of the district, and written notice of the hearing is filed with the offices of the Speaker of the Assembly and the President pro Tempore of the Senate at least 10 days prior to that date of the hearing.

Added by Stats. 1984, ch. 271.

Sec. 125. [Investment of Surplus Money]

Investment of surplus moneys of a district is governed by Article 1 (commencing with Section 53600) of Chapter 4, Part 1, Division 2, Title 5 of the Government Code.

Amended by Stats. 1969, ch. 441.

Sec. 125.5 Guidelines for intended use of unreserved fund balances.

On or before June 20, 2002, the board of directors of a district shall adopt a resolution establishing guidelines for the intended use of unreserved fund balances. The guidelines shall require that any disbursement of funds to member public agencies that represents a refund of money paid for the purchases of water shall be distributed based upon each member agency's purchase of water from the district during the previous fiscal year.

Added Stats. 2001 ch 632 §1 (SB350)

Sec. 126. [Dissemination of Information]

A district may disseminate information concerning the activities of the district, and whenever it shall be found by two-thirds vote of the board to be necessary for the protection of district rights and properties, the district may disseminate information concerning such rights and properties, and concerning matters which, in the judgment of the board, may adversely affect such rights and properties. Expenditures during any fiscal year for the purposes of this section shall not exceed one-half of one cent (\$0.005) for each one hundred dollars (\$100) of assessed valuation of the district.

Sec. 126.5.[Proscription on Use of Public Money for Investigations Relating to Elected Officials, Advocacy Groups, or Interested Persons: Right to Public Records]

(a) The Metropolitan Water District of Southern California and its member public agencies may not expend any public money for contracting with any private entity or person to undertake research or investigations with regard to the personal backgrounds or the statements of

board to be equitable, may fix rates for the sale and delivery to member public agencies of water obtained by the district from one source of supply in substitution for water obtained by the district from another and different source of supply, and may charge for such substitute water at the rate fixed for the water for which it is so substituted.

Sec. 134. [Adequacy of Water Rates; Uniformity of Rates]

The Board, so far as practicable, shall fix such rate or rates for water as will result in revenue which, together with revenue from any water stand-by or availability service charge or assessment, will pay the operating expenses of the district, provide for repairs and maintenance, provide for payment of the purchase price or other charges for property or services or other rights acquired by the district, and provide for the payment of the interest and principal of the bonded debt subject to the applicable provisions of this act authorizing the issuance and retirement of the bonds. Those rates, subject to the provisions of this chapter, shall be uniform for like classes of service throughout the district.

Amended by Stats. 1984, ch. 271

Sec. 134.5. [Water Standby or Availability of Service Charge]

(a) The board may, from time to time, impose a water standby or availability service charge within a district. The amount of revenue to be raised by the service charge shall be as determined by the board.

(b) Allocation of the service charge among member public agencies shall be in accordance with a method established by ordinance or resolution of the board. Factors that may be considered include, but are not limited to, historical water deliveries by a district; projected water service demands by member public agencies of a district; contracted water service demands by member public agencies of a district; service connection capacity; acreage; property parcels; population, and assessed valuation, or a combination thereof.

(c) The service charge may be collected from the member public agencies of a district. As an alternative, a district may impose a service charge as a standby charge against individual parcels within the district.

In implementing this alternative, a district may exercise the powers of a county water district under Section 31031 of the Water Code, except that, notwithstanding Section 31031 of the Water Code, a district may (1) raise the standby charge rate above ten dollars (\$10) per year by a majority vote of the board, and (2) after taking into account the factors specified in subdivision (b), fix different standby charge rates for parcels situated within different member public agencies.



San Diego County Water Authority

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November 17, 2014

Brett Barbre and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District
City of Del Mar
City of Escondido
City of National City
City of Oceanside
City of Poway
City of San Diego
Fallbrook
Public Utility District
Helix Water District
Lakeside Water District
Olivenhain
Municipal Water District
Otay Water District
Padre Dam
Municipal Water District
Camp Pendleton
Marine Corps Base
Rainbow
Municipal Water District
Ramona
Municipal Water District
Rincon del Diablo
Municipal Water District
San Dieguito Water District
Santa Fe Irrigation District
South Bay Irrigation District
Vallecitos Water District
Valley Center
Municipal Water District
Vista Irrigation District
Yuima
Municipal Water District
OTHER
REPRESENTATIVE
County of San Diego

RE: Finance and Insurance Committee Item 6c – Balancing Accounts

Dear Committee Chair Barbre and Members of the Board:

Thank you for placing the balancing accounts issue on the committee agenda this month.

In September, when staff last presented the item for discussion, we noted that the content of the presentation was not responsive to the question, namely, how can revenues from individual rates be tracked to improve accountability and ensure compliance with cost-of-service requirements. We are disappointed to see that the same non-responsive staff presentation will be made again this month.

The concept of balancing accounts is well-known and easy to understand. It is a long-standing accounting practice among private water utilities used to protect both the utility and its customers from changes in costs the utility has no ability to control (for example, the weather,) and at the same time, ensure that rates accurately reflect the costs of providing service. Because MWD now derives significant revenues from transportation services, it is imperative that MWD's accounting methods ensure all of its member agencies and ratepayers that the rates they are paying are fair, and used for the intended purpose as established during the public rate-setting and cost-of-service process.

We are asking that MWD implement an accounting mechanism that tracks revenues from all individual rates and expenditures associated with those rates. To the extent that MWD actual sales differ from forecasted sales, it may collect more or less than the revenue requirement upon which the rate for a particular service is determined. Discrepancies between revenue requirements and actual revenues and expenses are captured through balancing account mechanisms, which "true-up" the actual revenue to the revenue requirement in the following year. This "true-up" ensures that MWD only collects the revenue requirement for the rate that is charged in compliance with applicable law.

We do not understand why MWD would be unwilling to extend its current practice of tracking

A public agency providing a safe and reliable water supply to the San Diego region

Committee Chair Barbre and Members of the Board

November 17, 2014

Page 2

treatment and water stewardship rates to also include supply, system access and system power rates. We are asking only that MWD account for all of its rates just as it now does for its treatment and water stewardship rates. Tracking rates and revenue collection in this manner does not impede MWD's ability to meet bond covenants or any other requirement or function described in the staff presentation.

We are also concerned with the position expressed at the last committee meeting that the Water Rate Stabilization Fund (WRSF) requirements should flow into a single fund with board discretion to expend those funds on any purpose. The melding of surplus funds received from different rates and charges would necessarily lead to cross-funding of unrelated services. Furthermore, the priority for fund flows (dollars in/out) could first be to the separate fund accounts for each identified service, rather than flowing first to the WRSF, as is the current practice, or sub-account funds could be created within the WRSF to track and account for sources of the "puts" into the WRSF and the "takes" from the fund. This would ensure collections from the rate for each service are accounted for and attributed to that service. Surplus collections remaining in that account may then be used to mitigate corresponding rate increases in the following years so funds are spent for that service in accordance with cost-of-service and Proposition 26 (2010) requirements.

We look forward to discussing this important transparency issue at the committee and board meeting this month.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director



San Diego County Water Authority

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March 4, 2016

Marcia Scully, Esq.
General Counsel
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District
City of Del Mar
City of Escondido
City of National City
City of Oceanside
City of Poway
City of San Diego
Fallbrook
Public Utility District
Helix Water District
Lakeside Water District
Olivenhain
Municipal Water District
Otay Water District
Padre Dam
Municipal Water District
Camp Pendleton
Marine Corps Base
Rainbow
Municipal Water District
Ramona
Municipal Water District
Rincon del Diablo
Municipal Water District
San Dieguito Water District
Santa Fe Irrigation District
South Bay Irrigation District
Vallecitos Water District
Valley Center
Municipal Water District
Vista Irrigation District
Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

Re: San Diego Public Records Act Request of February 18, 2016

Dear Ms. Scully:

I have reviewed your February 26 correspondence, which responds to our February 18 California Public Records Act Request (the "Request"). As you know, the Request seeks categories of information necessary to evaluate MWD's current proposed rates for 2017 and 2018.

In your correspondence, you have denied our request for Metropolitan's financial planning model, claiming that it is exempt under Government Code section 6254.9 as "a proprietary software program developed by Metropolitan that contains nondisclosable formulas and programming code." As you note, the Water Authority received the previous financial planning model in 2013. That disclosure, made in litigation, was subject to a protective order requested by MWD, which for timing reasons, the Water Authority chose not to challenge at that time. Our Request seeks public disclosure of the financial planning model, with updated data, relating to the current rate setting process for 2017 and 2018 rates and charges.

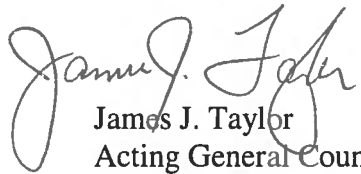
You may or may not be aware, after the protective order was issued, the California Supreme Court issued a decision that confirms the Water Authority's position that the data contained within MWD's financial planning model is a disclosable public record, and is not exempt from disclosure under Government Code 6254.9. See Sierra Club v. Superior Court (2013) 57 Cal.4th 157. Therefore, we ask again that MWD immediately provide us with its current financial planning model, in a fully functional electronic format, including all of the data contained therein. If MWD still refuses to do so, we will have no choice but to commence litigation to obtain this information, which is necessary in order to analyze how MWD has assigned its costs and set its rates.

As to the other requested records, your correspondence notes that MWD will notify us in 14 days of the date on which you will provide responsive records. However, a delay in both your response and the production of records is unacceptable since MWD is currently

Marcia Scully
March 4, 2016
Page 2

in the process of setting rates that will be formally acted upon by the board at its April 12 board meeting. Given the immediacy of rate adoption, it is evident that the responsive records, which all seek the underlying data that MWD used in determining its proposed rates, are readily available and should be immediately disclosed. Since the public hearing on MWD's proposed rates is just four days away, and the proposed rates are scheduled to be adopted on April 12, it is of great public importance that both MWD and the public receive as much information as possible now. At a minimum, MWD should immediately provide access to all available data, including any cost of service studies or reports upon which the data rely, and studies that may have been conducted, and more detailed budget information to the lowest level of data that MWD collects or uses to develop the budget (typically, this would include line by line account numbers, by department, including all activities and programs). Any additional data should also be provided on a rolling production basis.

Sincerely,


James J. Taylor
Acting General Counsel



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Counsel

February 26, 2016

James J. Taylor, Esq.
General Counsel
San Diego County Water Authority
4677 Overland Avenue
San Diego, California 92123-1233

Dear Mr. Taylor:

Response to Public Records Act Request Dated February 18, 2016

We received your Public Records Act request, dated February 18, 2016, on that date. A copy of your request is attached.

This response is made in compliance with California Government Code Section 6253(c), which requires an agency to notify a person making a request within 10 days whether a request seeks disclosable records. We have determined that your request seeks disclosable records, with the exception of Metropolitan's financial planning model, which is exempt from disclosure under Government Code Section 6254.9(a) as a proprietary software program developed by Metropolitan that contains nondisclosable formulas and programming code.¹

Disclosable records that are responsive to your request, to the extent material has not already been provided to the Metropolitan Board, are being collected and will be provided to SDCWA in electronic format on DVD(s).

Pursuant to Government Code Section 6253(c), Metropolitan will notify you within 14 days of the date on which we will provide the responsive and disclosable records to you. The voluminous amount of records and our need to remove the proprietary formulas and code from spreadsheets impact the timing of the production and our ability to state the production date at

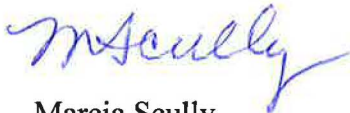
¹ SDCWA already received the financial planning model through the rate litigation, subject to the parameters and restrictions of the Court's protective order, so SDCWA has had full opportunity to view it and understands its operations.

James J. Taylor, Esq.
February 26, 2016
Page 2

this time. We will also post this material on-line so it is available to all Metropolitan Board members, member agency staff, and the public. In addition, if any Board member would like, we will provide the material to them on DVD(s).

Thank you for your request. Please direct all communications regarding your request to me.

Very truly yours,



Marcia Scully
General Counsel



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

February 18, 2016

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
Public Utility District

Helix Water District

Lakeside Water District

Olivenhain
Municipal Water District

Otay Water District

Padre Dam
Municipal Water District

Camp Pendleton
Marine Corps Base

Rainbow
Municipal Water District

Ramona
Municipal Water District

Rincon del Diablo
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Vista Irrigation District

Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

Ms. Dawn Chin
Board Executive Secretary
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

Re: Request for Records Under California Public Records Act
(California Gov. Code § 6250 *et seq.*)

Dear Ms. Chin:

On behalf of my client, the San Diego County Water Authority ("SDCWA"), and pursuant to the California Public Records Act ("PRA"), California Government Code section 6250 *et seq.*, we request the following public records which are in the possession or control of the Metropolitan Water District of Southern California (hereinafter "MWD"). "MWD," as used herein, includes MWD itself, MWD's officers, representatives, agents, employees, affiliates, accountants, consultants, attorneys, MWD's Board of Directors, its individual directors, and any and all persons acting on MWD's behalf. "MWD's Board" and "MWD's Board of Directors," as used herein, includes the Board of Directors as a whole, its directors and all relevant Standing, Ad Hoc, Special Purpose, Temporary Committees, and all other appointments.

This request applies to every such record that is known to MWD and which MWD can locate or discover by reasonably diligent efforts. More specifically, the records that may contain information called for by this request include:

- Documents, communications, letters, memoranda, notes, reports, papers, files, books, records, contracts, agreements, telegrams, electronic mail (saved or deleted), and other communications sent or received;
- Printouts, diary entries and calendars, drafts, tables, compilations, tabulations, charts, spreadsheets, graphs, recommendations, accounts, worksheets, logs, work papers, minutes, notes, summaries, speeches, presentations, and other written records or recordings of or relating to any conference, meeting, visit, interview, or telephone conversations;
- Bills, statements, invoices, and other records of any obligation or expenditure, cancelled checks, vouchers, receipts, and other records of payment;
- Financial and statistical data, analyses, surveys and schedules;
- Audiotapes and videotapes and cassettes and transcripts thereof, affidavits, transcripts of testimony, statements, interviews, and conversations;

Ms. Dawn Chin
February 18, 2016
Page 2

- Printed matter (including published articles, speeches, newspaper clippings, press releases, and photographs); and
- Microfilm and microfiche, disks, computer files, electronically stored data (including the metadata associated with any such written and/or spoken content), electronically stored information, electronic devices, film, tapes, and other sources from which information can be obtained, including materials used in electronic data processing. "Electronic" means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities. "Electronically stored information" means information that is stored in an electronic medium, including data, metadata, and all electronically stored data or information.

The term "related to," as used in each category of public record listed below, means directly or indirectly, in whole or in part, comprising, referring to, concerning, evidencing, connected with, commenting on, affecting, responding to, showing, describing, discussing, analyzing, reflecting or constituting.

The term "rate model," as used in each category of public record listed below, means all documents, data, analyses, calculations, studies or other information that constitute, comprise, support or describe the manner in which MWD assigns costs to rates, including but not limited to its "financial planning model," including the spreadsheet, formulas and programming code.

If a record responsive to a request was, but no longer is, in your possession, custody, or control, state precisely what disposition was made of it (including its present location and who possesses or controls it) and identify the person(s) who authorized or ordered such disposition.

Records produced in response to this request should be produced as they are kept in the usual course of business or should be organized and labeled to correspond with the categories in the request. All electronically stored information shall be produced in its native format with all metadata intact.

The requested records are:

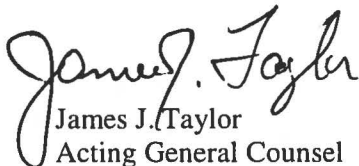
1. Any rate model or models used in formulating proposed rates for the 2017 and 2018 calendar years.
2. All data, analyses and studies, if any, and cost of service analysis used to generate or supporting the rates and charges proposed for the 2017 and 2018 calendar years, as described in MWD Board Memo 9-2 dated 2/9/2016 (Finance and Insurance Committee).
3. All data, analyses and studies, if any, and cost of service analysis used to generate or supporting a proposed reduction of the Readiness-to-Serve and Capacity Charges for 2017.
4. All data, analyses and studies, if any, demonstrating the proportionate benefit each of MWD's 26 customer member agencies will receive from the expenditure of revenues collected from the rates and charges proposed for the 2017 and 2018 calendar years.
5. All data, analyses and studies, if any, that support the conclusion that demand management programs provide distribution and conveyance system benefits, including identification of those parts of the distribution and conveyance system where additional capacity is needed and the customer member agencies that benefit from that capacity being made available.

Ms. Dawn Chin
February 18, 2016
Page 3

6. All data, analyses, opinions and studies, if any, that support the conclusion that suspension of the property tax restriction in Section 124.5 of the MWD Act is essential to MWD's fiscal integrity, as described in MWD Board Memo 9-2 at page 3.
7. All data, analyses and studies, if any, supporting the findings, conclusions, recommendations and water supply development targets identified in MWD's 2015 IRP Technical Update Issue Paper Addendum.
8. All data, analyses and studies, if any, supporting the findings, conclusions, recommendations and water supply development targets identified in MWD's Integrated Water Resources Plan 2015 Update.

Within ten (10) days of receipt of this PRA request, please contact me at (858) 522-6791 to discuss whether MWD has records responsive to this request, the page count and cost of copying the records, and whether the documents are also available in electronic format.

Sincerely,


James J. Taylor
Acting General Counsel

cc: MWD Public Records Administrator (by email at praadministration@mwdh2o.com)



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

August 15, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
Public Utility District

Helix Water District

Lakeside Water District

Olivenhain
Municipal Water District

Otay Water District

Padre Dam
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Camp Pendleton
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Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Vista Irrigation District

Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

RE: Board Memo 5G-2 - Adopt (1) the resolution finding that continuing an ad valorem tax rate at the rate levied for fiscal year 2013/14 is essential to Metropolitan's fiscal integrity; and (2) the resolution establishing the tax rate for fiscal year 2014/15 - OPPOSE OPTION 1

Dear Chair Record and Board Members,

We have reviewed Board Memo 5G-2 and OPPOSE the action recommended to be adopted by the Board of Directors (i.e., to suspend the tax limitation of Section 124.5, thereby increasing the amount of property tax revenue to be collected by MWD). We have stated our objections previously, each time MWD has proposed to suspend the property tax rate limitations imposed by the Legislature, now embodied in Section 124.5 of the MWD Act. Copies of our May 14, June 5 and August 16, 2013 letters are attached for your ease of reference (Attachment 1). We SUPPORT adoption of OPTION 2 as described at page one of the Board Memorandum.

We OPPOSE the action recommended by staff because MWD has failed to make the requisite factual showing that additional tax revenues are "essential to the fiscal integrity of the District." Such a finding would be impossible to make given that MWD has collected almost \$800 million more than necessary to pay the actual expense items included in its adopted budgets over the past three years (even with this spending, MWD still has substantial cash reserves that are nearly at the maximum level prescribed by the Board of Directors). The fact that the MWD board later chose to spend this rate revenue on unbudgeted expenditures does not change the fact that these revenues were available to the District and therefore the collection of higher taxes was not, and is not necessary, let alone "essential" to the fiscal integrity of the district.

MWD has also failed to show why the other fixed revenue options it has available, such as the Readiness-to-Serve charge and benefit assessments, are not feasible. Indeed, it is clear from the legislative history of SB 1445 that the Legislature intended that MWD would use

A public agency providing a safe and reliable water supply to the San Diego region

Chair Record and Members of the Board

August 15, 2015

Page 2

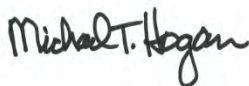
these alternatives in lieu of property taxes. See April 21, 1988 Memorandum from MWD's General Counsel to the Subcommittee on Financial Policy (Attachment 2).

Board Memorandum 5G-2 is incorrect when it states that MWD's fixed costs, particularly its fixed State Water Contract obligations, are increasing "in ways unforeseen by the Legislature in 1984" (Board Memorandum 5G-2, last paragraph at page 4). To the contrary, MWD's own Report to the California Legislature in Response to AB 322 (March 1984), clearly identified that fixed costs of the State Water Project were expected to increase dramatically (excerpts from the Report - Figures 18 and 19 - are included as Attachment 3).

We also OPPOSE staff recommendation because MWD has failed to provide the public with sufficient information to have a reasonable opportunity to be heard at the public hearing, as required by Section 124.5. The Board meeting agenda does not even reference the related Committee agenda item. Even if the Board Memorandum is located by a member of the public, it asks them to cull through all of the financial information appearing on MWD's web site, rather than providing an analysis of MWD's current financial condition, demonstrating that increased tax revenues are "essential" to its fiscal integrity within the meaning of the statute passed by the Legislature and signed into law (SB 1445).

MWD needs a long-range finance plan to address how it will pay for current and anticipated costs of the State Water Project. Revenues from property taxes – as one source of revenues, fixed or otherwise – should be considered and discussed by the board in the broader context of a plan to ensure MWD's long-term fiscal sustainability. Taking action, one year at a time, to increase property tax revenues without a comprehensive long-term fiscal strategy and plan does little to assure the public and our ratepayers that MWD is a fiscally prudent and sustainable agency. We would welcome the opportunity to have that dialogue.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachments:

1. Water Authority's Letters to MWD Board (May 14, June 5 and August 16, 2013)
2. Memorandum from MWD's General Counsel to the Subcommittee on Financial Policy (April 21, 1988)
3. MWD Report to California Legislature in Response to AB 322, excerpts - Figures 18 and 19 (March 1984)




Finance and Insurance Committee Meeting

Consideration of Alternative Treatment Cost Recovery Mechanism

February 23, 2016

Objectives-Goals

- Objective – Fixed Charge Concept
 - Cost of Service
 - Align charges with service commitment/investment
 - Cost recovery – revenue stability

Treatment Fixed Charge Concept

- 38% of total Treatment revenue requirements
 - Cost of Service based: sum of Treatment Demand and Standby costs
 - Used to develop fixed or demand charge

Fixed Cost Recovery - An Industry Perspective

- Cost-of-service considerations – What is the cost of providing on-demand service and standby service?
- Declining water use driving trend to increase fixed cost recovery – fixed revenues

Align Charges with Service Commitment/Investment

- MWD is the treated water service provider for Member Agencies
- MWD service obligation – be capable of meeting average and peak week treated water demands of Member Agencies
- Investment in treatment capacity designed to meet the needs of Member Agencies
- Meet average and peak week demands AND provide on-demand and standby capacity

Treatment Fixed Charge Concept (\$ millions)

FY 2016/17 Treatment Revenue Requirement	
Direct O&M at WTPs	\$59
Indirect O&M (WSO, IT, Eng., HR)	46
A&G (Legal, Finance, Audit, Ethics)	30
Capital Costs (Debt, PAYGO)	140
	54% of Total
LESS: Revenue Offsets / Decline in Reserves	<u>-18</u>
TOTAL Net Revenue Requirement	\$257



5



6



Treatment Fixed Charge Concept (\$ millions)

FY 2016/17 Treatment Revenue Requirement		\$257 (100%)
Variable		\$24 (9%)
Fixed		\$233 (91%)
Commodity	\$135	38% of Total
Demand	\$41	
Standby	\$57	

Current Treatment Surcharge: 100% Volumetric Cost Recovery

- $\frac{\text{Revenue Requirement}}{\text{Treated Water Sales}} = \$/AF \text{ Volumetric Rate}$
 - Demand and Standby treatment capacity and reduced treated water sales revenue
 - Potential for Member Agencies to stop using the MWD treatment system and make no contribution to Demand and Standby-related costs
 - MWD retains the obligation to serve Member Agencies



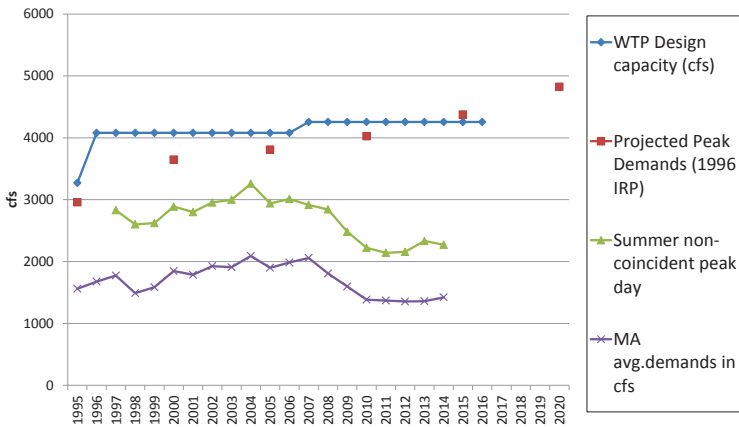
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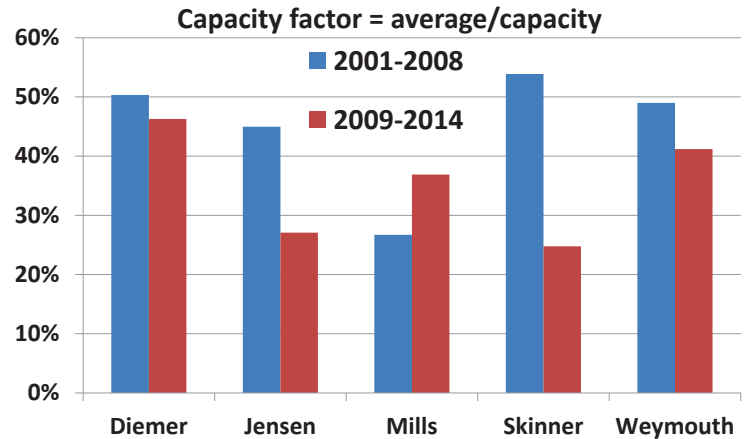
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Long-Term Treated Water Demand Has Not Materialized



WTP Utilization Has Declined



Align Charges with Service Commitment/Investment

Cost of Service principles, i.e., pay for the service provided:

Member Agencies pay only when taking treated water and in effect require all system users to bear the cost burden for demand or standby capacity

MWD has invested in treatment capacity to serve the Member Agencies, but today does not require the beneficiaries of demand or standby capacity to pay anything for the cost of this dedicated capacity; for the cost of this service

Fixed Cost Recovery Cost-of-Service Perspective

- Demand or standby service – “...rate charged should reflect the cost of having capacity reserved and available for the customer.”(1)
 - Fixed Demand Charge – reflect peaking costs and demands
 - Consumption Rate

(1) AWWA M1 Principles of Water Rates, Fees, and Charges, Sixth Edition

Fixed Revenue Recovery is Common

Agency	Wholesale Cost Recovery
Massachusetts Water Resource Authority, MA	Customers are assessed a <u>fixed annual amount based on their proportional share of the previous year's demand</u> . FY 2015 assessment = \$3,239 per million gallons. Fixed revenue recovery = 100%.
North Texas Municipal Water District, TX	Customers pay on a volumetric basis. Fixed costs are recovered under <u>take-or-pay contracts based on the higher of estimated test-year demand or the maximum volume of water used in any previous year</u> . FY 2016 fixed charge = \$1.88 per kgal. Estimated fixed revenue recovery = 85%.
Upper Trinity Regional Water District, TX	Customers pay their proportionate share of demand costs under <u>take-or-pay contracts based on a minimum daily volume equal to 18% of their highest peak day demand in the preceding five-year period</u> . FY 2015 annual demand charge = \$388,110 per MGD. Estimated fixed revenue recovery under minimum take-or-pay contracts = 78%.
San Francisco Public Utilities Commission, CA	4 wholesale customers are subject to a <u>take-or-pay requirement specifying a minimum annual volume</u> they must purchase. Estimated fixed revenue recovery from wholesale customers under minimum take-of-pay contracts = 24%.

Fixed Revenue Recovery is Common

Agency	Wholesale Cost Recovery
Great Lakes Water Authority, MI	<u>60% of the annual revenue requirement is estimated to be recovered through a fixed demand charge</u> ; 40% recovered through volumetric rates.
Jordon Valley Water Conservancy District, UT	Each wholesale customer has a <u>contracted take-or-pay minimum purchase volume</u> . Estimated fixed revenue recovery from wholesale customers under minimum take-or-pay contracts = 100%.
Dallas Water Utilities, TX	Wholesale customers pay a <u>fixed demand charge</u> and a volumetric rate. The demand charge is based on the higher of current year demand or the average of the previous five years. Demand charge is \$243,453 per mgd per year and the volumetric rate is \$0.4305 per kgal. Estimated fixed charge revenue from wholesale customers = 60%.
Portland Water Bureau, OR	Wholesale customers specify a <u>minimum annual "guaranteed purchase quantity"</u> as well as seasonal and daily peaking factor. If actual peaking factors exceed those specified, customers must pay a surcharge. Fixed revenue recovery from wholesale customers under minimum take-of-pay contracts = 100%

Current Treatment Surcharge: 100% Volumetric Cost Recovery

- $$\frac{\text{Revenue Requirement}}{\text{Treated Water Sales}} = \$/AF \text{ Volumetric Rate}$$
 - Demand and Standby treatment capacity and reduced treated water sales revenue
 - Potential for Member Agencies to stop using the MWD treatment system and make no contribution to Demand and Standby-related costs
 - MWD retains the obligation to serve Member Agencies

FY 2016/17 Treatment Revenue Requirement (Hypothetical Pro Forma – For Example Only)

Status Quo Treated Surcharge (\$/AF)	
Treatment Revenue Requirement	\$257,479,354
Forecasted Treated Water Sales (AF)	<u>822,000</u>
Treated Surcharge (\$/AF)	\$313



FY 2016/17 Status Quo Treatment Surcharge (100% Volumetric) (HYPOTHETICAL PRO FORMA - FOR EXAMPLE ONLY)					
Member Agency	Projected Test Year Treated Water Sales		x	Total Revenue Requirement =	Member Agency Revenue Requirement
	AF	%			
Anaheim	3,947	0.48%	x	\$257,479,354 =	\$1,236,208
Beverly Hills	10,212	1.24%	x	257,479,354 =	3,198,735
Burbank	6,354	0.77%	x	257,479,354 =	1,990,241
Calleguas	88,943	10.82%	x	257,479,354 =	27,860,023
Central Basin	27,937	3.40%	x	257,479,354 =	8,750,956
Compton	0	0.00%	x	257,479,354 =	87
Eastern	53,248	6.48%	x	257,479,354 =	16,679,159
Foothill	7,461	0.91%	x	257,479,354 =	2,337,078
Fullerton	7,639	0.93%	x	257,479,354 =	2,392,937
Glendale	15,693	1.91%	x	257,479,354 =	4,915,618
Inland Empire	0	0.00%	x	257,479,354 =	0
Las Virgenes	20,314	2.47%	x	257,479,354 =	6,362,979
Long Beach	42,391	5.16%	x	257,479,354 =	13,278,470
Los Angeles	61,097	7.43%	x	257,479,354 =	19,137,588
MWDOC	141,285	17.19%	x	257,479,354 =	44,255,500
Pasadena	17,238	2.10%	x	257,479,354 =	5,399,667
San Diego CWA	97,266	11.83%	x	257,479,354 =	30,467,286
San Fernando	92	0.01%	x	257,479,354 =	28,723
San Marino	673	0.08%	x	257,479,354 =	210,923
Santa Ana	4,929	0.60%	x	257,479,354 =	1,543,796
Santa Monica	3,920	0.48%	x	257,479,354 =	1,227,816
Three Valleys	36,641	4.46%	x	257,479,354 =	11,477,206
Torrance	14,919	1.81%	x	257,479,354 =	4,673,233
Upper San Gabriel	8,350	1.02%	x	257,479,354 =	2,615,453
West Basin	103,936	12.64%	x	257,479,354 =	32,556,355
Western MWD	47,515	5.78%	x	\$257,479,354 =	14,883,317
TOTAL	822,000	100.00%			\$257,479,354
				Unit Cost per AF	\$313

Proposed Treatment Rate Design: Volumetric + Fixed Revenue Recovery

- Volumetric Revenue Recovery = 62%

$$\frac{\text{Revenue Requirement}}{\text{Treated Water Sales}} = \$/\text{AF Volumetric Rate}$$

- Fixed Revenue Recovery = 38%

$$\text{Revenue Requirement} * \text{Proportional Demand} = \$ \text{Annual Fixed Charge}$$

Proposed Treatment Rate Design: Volumetric + Fixed Revenue Recovery

2-Part Test for Minimum Demand

Greater of:

- TYRA of Treated Water Sales *OR*
- Average of 1998 – 2007 Treated Water Sales

2007 was the last significant treatment plant capacity addition

FY 2016/17 Treatment Revenue Requirement

Status Quo Treatment Surcharge (\$/AF)	
Total Treatment Revenue Requirement	\$257,479,354
Forecast Treated Water Sales (AF)	<u>822,000</u>
Treated Surcharge (\$/AF)	\$313
Treatment Fixed Annual Charge (\$/AF)	
Fixed Demand	\$40,822,844
Fixed Standby	56,724,561
Total Fixed Charge Revenue Requirement	\$97,547,405
% of Total Revenue Requirement	37.9%
Fixed Charge Units of Service (AF)	<u>1,341,701</u>
Annual Fixed Charge (\$/AF)	\$73
Treatment Volumetric Rate (\$/AF)	
Net Remaining Revenue Requirement	\$159,931,949
% of Total Revenue Requirement	62.1%
Forecast Treated Water Sales (AF)	<u>822,000</u>
Volumetric Rate (\$/AF)	\$195

FY 2016/2017 Member Agency Fixed Charge Revenue Requirement (38% Revenue Recovery)
(HYPOTHETICAL PRO FORMA - FOR EXAMPLE ONLY)

Member Agency	AVG. 1998 - 2007 Treated Water Sales (AF)	TYRA 2006 - 2015 Treated Water Sales (AF)	Units Used in Fixed Charge Calculation	% of Total	x	Total Fixed Charge Revenue Requirement	=	Member Agency Annual Fixed Revenue Requirement
Anaheim	13,134	12,126	13,134	0.98%	X	\$97,547,405	=	\$954,911
Beverly Hills	13,008	11,386	13,008	0.97%	x	97,547,405	=	945,725
Burbank	12,816	10,089	12,816	0.96%	x	97,547,405	=	931,758
Calleguas	112,585	114,712	114,712	8.55%	x	97,547,405	=	8,340,091
Central Basin	67,191	46,198	67,191	5.01%	x	97,547,405	=	4,885,071
Compton	3,514	1,924	3,514	0.26%	x	97,547,405	=	255,451
Eastern	73,423	73,323	73,423	5.47%	x	97,547,405	=	5,338,173
Foothill	11,623	9,933	11,623	0.87%	x	97,547,405	=	845,074
Fullerton	11,513	11,072	11,513	0.86%	x	97,547,405	=	837,031
Glendale	25,094	19,585	25,094	1.87%	x	97,547,405	=	1,824,421
Inland Empire	0	0	0	0.00%	x	97,547,405	=	0
Las Virgenes	22,106	22,810	22,810	1.70%	x	97,547,405	=	1,658,376
Long Beach	44,267	36,397	44,267	3.30%	x	97,547,405	=	3,218,416
Los Angeles	79,762	87,950	87,950	6.56%	x	97,547,405	=	6,394,377
MWDOC	244,203	204,975	244,203	18.20%	x	97,547,405	=	17,754,580
Pasadena	21,779	21,181	21,779	1.62%	x	97,547,405	=	1,583,398
San Diego CWA	251,381	156,458	251,381	18.74%	x	97,547,405	=	18,276,450
San Fernando	387	206	387	0.03%	x	97,547,405	=	28,135
San Marino	1,041	931	1,041	0.08%	x	97,547,405	=	75,664
Santa Ana	15,788	13,331	15,788	1.18%	x	97,547,405	=	1,147,853
Santa Monica	12,627	9,252	12,627	0.94%	x	97,547,405	=	918,014
Three Valleys	49,467	41,833	49,467	3.69%	x	97,547,405	=	3,596,498
Torrance	21,052	18,130	21,052	1.57%	x	97,547,405	=	1,530,565
Upper San Gabriel	13,963	7,346	13,963	1.04%	x	97,547,405	=	1,015,173
West Basin	145,421	125,668	145,421	10.84%	x	97,547,405	=	10,572,734
Western MWD	61,511	63,538	63,538	4.74%	x	\$97,547,405	=	4,619,464
TOTAL	1,328,654	1,120,354	1,341,701	100.00%				\$97,547,405
Annual Fixed Charge (\$/AF)								\$73

FY 2016/2017 Member Agency Volumetric Revenue Requirement (62% Volumetric)
(HYPOTHETICAL PRO FORMA - FOR EXAMPLE ONLY)

Member Agency	Projected Test-Year Treated Water Sales		x	Total Revenue Requirement	=	Member Agency Revenue Requirement
	AF	%				
Anaheim	3,947	0.48%	X	\$159,931,949	=	\$767,864
Beverly Hills	10,212	1.24%	x	159,931,949	=	1,986,877
Burbank	6,354	0.77%	x	159,931,949	=	1,236,228
Calleguas	88,943	10.82%	x	159,931,949	=	17,305,107
Central Basin	27,937	3.40%	x	159,931,949	=	5,435,611
Compton	0	0.00%	x	159,931,949	=	54
Eastern	53,248	6.48%	x	159,931,949	=	10,360,172
Foothill	7,461	0.91%	x	159,931,949	=	1,451,664
Fullerton	7,639	0.93%	x	159,931,949	=	1,486,361
Glendale	15,693	1.91%	x	159,931,949	=	3,053,310
Inland Empire	0	0.00%	x	159,931,949	=	0
Las Virgenes	20,314	2.47%	x	159,931,949	=	3,952,331
Long Beach	42,391	5.16%	x	159,931,949	=	8,247,852
Los Angeles	61,097	7.43%	x	159,931,949	=	11,887,212
MWDOC	141,285	17.19%	x	159,931,949	=	27,489,072
Pasadena	17,238	2.10%	x	159,931,949	=	3,353,975
San Diego CWA	97,266	11.83%	x	159,931,949	=	18,924,595
San Fernando	92	0.01%	x	159,931,949	=	17,841
San Marino	673	0.08%	x	159,931,949	=	131,014
Santa Ana	4,929	0.60%	x	159,931,949	=	958,921
Santa Monica	3,920	0.48%	x	159,931,949	=	762,651
Three Valleys	36,641	4.46%	x	159,931,949	=	7,129,006
Torrance	14,919	1.81%	x	159,931,949	=	2,902,754
Upper San Gabriel	8,350	1.02%	x	159,931,949	=	1,624,575
West Basin	103,936	12.64%	x	159,931,949	=	20,222,209
Western MWD	47,515	5.78%	x	\$159,931,949	=	9,244,694
TOTAL	822,000	100.00%				\$159,931,949
Volumetric \$/AF						\$199

Summary of FY 2016/2017 Member Agency Treatment Revenue Requirement Impacts
(HYPOTHETICAL PRO FORMA - FOR EXAMPLE ONLY)



Member Agency	Status Quo Treated Water Surcharge	Proposed Rate Design				% Difference From Status Quo
		Fixed Charge Revenue Requirement	Volumetric Revenue Requirement	Total Revenue Requirement	\$ Difference From Status Quo	
Anaheim	\$1,236,208	\$954,911	\$767,864	\$1,722,775	\$486,567	39%
Beverly Hills	3,198,735	945,725	1,986,877	2,932,602	(266,132)	-8%
Burbank	1,990,241	931,758	1,236,228	2,167,985	177,745	9%
Calleguas	27,860,023	8,340,091	17,305,107	25,645,198	(2,214,825)	-8%
Central Basin	8,750,956	4,885,071	5,435,611	10,320,681	1,569,725	18%
Compton	87	255,451	54	255,505	255,418	> 100%
Eastern	16,679,159	5,338,173	10,360,172	15,698,345	(980,813)	-6%
Foothill	2,337,077	845,074	1,451,664	2,296,738	(40,340)	-2%
Fullerton	2,392,937	837,031	1,486,361	2,323,392	(69,545)	-3%
Glendale	4,915,618	1,824,421	3,053,310	4,877,732	(37,886)	-1%
Inland Empire	0	0	0	0	0	0%
Las Virgenes	6,362,979	1,658,376	3,952,331	5,610,707	(752,272)	-12%
Long Beach	13,278,470	3,218,416	8,247,852	11,466,268	(1,812,202)	-14%
Los Angeles	19,137,588	6,394,377	11,887,212	18,281,589	(855,999)	-4%
MWDOC	44,255,500	17,754,580	27,489,072	45,243,652	988,152	2%
Pasadena	5,399,667	1,583,398	3,353,975	4,937,373	(462,295)	-9%
San Diego CWA	30,467,286	18,276,450	18,924,595	37,201,045	6,733,759	22%
San Fernando	28,723	28,135	17,841	45,976	17,253	60%
San Marino	210,923	75,664	131,014	206,678	(4,245)	-2%
Santa Ana	1,543,796	1,147,853	958,921	2,106,774	562,978	36%
Santa Monica	1,227,816	918,014	762,651	1,680,665	452,849	37%
Three Valleys	11,477,206	3,596,498	7,129,006	10,725,505	(751,701)	-7%
Torrance	4,673,233	1,530,565	2,902,754	4,433,319	(239,914)	-5%
Upper San Gabriel	2,615,453	1,015,173	1,624,575	2,639,748	24,295	1%
West Basin	32,556,355	10,572,734	20,222,209	30,794,944	(1,761,412)	-5%
Western MWD	14,883,317	4,619,464	9,244,694	13,864,158	(1,019,159)	-7%
TOTAL	\$257,479,354	\$97,547,405	\$159,931,949	\$257,479,354	\$0	0%

Proposed Treatment Rate Design: Volumetric + Fixed Revenue Recovery

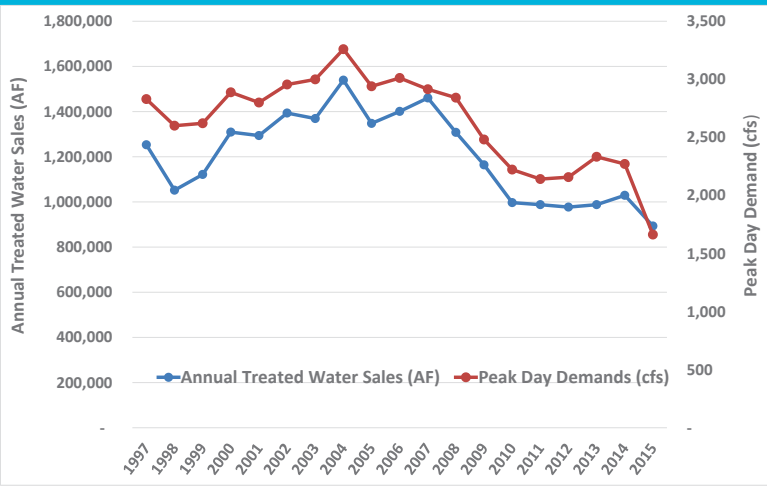
2-Part Test for Minimum Demand

Questions – Concerns from 1-15-16 Manager's Meeting:

1. How are peak demands captured?
2. Minimum forever?


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Correlation Between Annual Treated Sales and Treated Peak Day Demands = .95



Member Agency	Minimum: > of 1998-2007 OR 2006 - 2015 TYRA	Minimum: > of 1998 - 2007 OR 2006 - 2015 TYRA AND 2013 - 2015 Peaking	\$ Difference	% Difference
Anaheim	\$1,722,775	\$1,880,003	\$157,228	9%
Beverly Hills	2,932,602	3,056,005	123,402	4%
Burbank	2,167,985	2,158,712	(9,274)	0%
Calleguas	25,645,198	26,269,066	623,868	2%
Central Basin	10,320,681	9,515,216	(805,465)	-8%
Compton	255,505	197,671	(57,833)	-23%
Eastern	15,698,345	16,869,107	1,170,761	7%
Foothill	2,296,738	2,278,411	(18,326)	-1%
Fullerton	2,323,392	2,346,647	23,255	1%
Glendale	4,877,732	4,869,738	(7,994)	0%
Inland Empire	0	0	0	---
Las Virgenes	5,610,707	5,799,214	188,506	3%
Long Beach	11,466,268	11,260,314	(205,954)	-2%
Los Angeles	18,281,589	19,169,363	887,774	5%
MWD/OC	45,243,652	44,086,858	(1,156,794)	-3%
Pasadena	4,937,373	5,159,315	221,942	4%
San Diego CWA	37,201,045	35,379,254	(1,821,791)	-5%
San Fernando	45,976	116,636	70,660	154%
San Marino	206,678	297,300	90,623	44%
Santa Ana	2,106,774	1,956,865	(149,909)	-7%
Santa Monica	1,680,665	1,678,702	(1,963)	0%
Three Valleys	10,725,505	11,372,852	647,347	6%
Torrance	4,433,319	4,367,355	(65,964)	-1%
Upper San Gabriel	2,639,748	2,569,783	(69,965)	-3%
West Basin	30,794,944	30,246,079	(548,865)	-2%
Western MWD	13,864,158	14,578,887	714,729	5%
TOTAL	\$257,479,354	\$257,479,354	\$0	0%

Member Agency	Status Quo Treated Water Surcharge	Option #1		Option #2		Dollar Difference from Status Quo	
		Minimum: > of 1998-2007 OR 2006-2015 TYRA	Minimum > of 1998-2007 OR 2006-2015 TYRA AND 2013-2015 PEAKING	Option #1	Option #2	Option #1	Option #2
Anaheim	\$1,236,208	\$1,722,775	\$1,880,003	\$486,567	\$643,795		
Beverly Hills	3,198,735	2,932,602	3,056,005	(266,132)	(142,730)		
Burbank	1,990,241	2,167,985	2,158,712	177,745	168,471		
Calleguas	27,860,023	25,645,198	26,269,066	(2,214,825)	(1,590,957)		
Central Basin	8,750,956	10,320,681	9,515,216	1,569,725	764,260		
Compton	87	255,505	197,671	255,418	197,585		
Eastern	16,679,159	15,698,345	16,869,107	(980,813)	189,948		
Foothill	2,337,078	2,296,738	2,278,411	(40,340)	(58,666)		
Fullerton	2,392,937	2,323,392	2,346,647	(69,545)	(46,290)		
Glendale	4,915,618	4,877,732	4,869,738	(37,886)	(45,880)		
Inland Empire	0	0	0	0	0		
Las Virgenes	6,362,979	5,610,707	5,799,214	(752,272)	(563,765)		
Long Beach	13,278,470	11,466,268	11,260,314	(1,812,202)	(2,018,156)		
Los Angeles	19,137,588	18,281,589	19,169,363	(855,999)	31,776		
MWD/OC	44,255,500	45,243,652	44,086,858	988,152	(168,642)		
Pasadena	5,399,667	4,937,373	5,159,315	(462,295)	(240,353)		
San Diego CWA	30,467,286	37,201,045	35,379,254	6,733,759	4,911,968		
San Fernando	28,723	45,976	116,636	17,253	87,913		
San Marino	210,923	206,678	297,300	(4,245)	86,378		
Santa Ana	1,543,796	2,106,774	1,956,865	562,978	413,069		
Santa Monica	1,227,816	1,680,665	1,678,702	452,849	450,887		
Three Valleys	11,477,206	10,725,505	11,372,852	(751,701)	(104,354)		
Torrance	4,673,233	4,433,319	4,367,355	(239,914)	(305,878)		
Upper San Gabriel	2,615,453	2,639,748	2,569,783	24,295	(45,670)		
West Basin	32,556,355	30,794,944	30,246,079	(1,761,412)	(2,310,277)		
Western MWD	14,883,317	13,864,158	14,578,887	(1,019,159)	(304,430)		
Total	\$257,479,354	\$257,479,354	\$257,479,354	\$0	\$0		

Minimum Forever?

- Under Status Quo and All Approaches, service levels should be re-defined in conjunction with treatment plant capacity decisions

Recommended Approach

- Volume Rate and Fixed Charge Based on a Minimum
 - Appropriate assignment of demand and standby capacity costs
- Peaking Could be Considered as Part of the Fixed Charge Determination



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Status Quo

- Maintain Current 100% Volumetric Treatment Cost Recovery



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Summary

- Recommended Fixed-Minimum and Volume Method
 - Acknowledge treatment cost of service – Demand and Standby-related costs
 - Enhance treatment and total system fixed revenue recovery



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METROPOLITAN WATER DISTRICT
BLUE RIBBON TASK FORCE

FINAL REPORT
JANUARY
1994

METROPOLITAN WATER DISTRICT

BLUE RIBBON TASK FORCE

FINAL REPORT

Foreword: The Blue Ribbon Task Force

On April 7, 1993, the Metropolitan Water District Board of Directors authorized the formation of a Blue Ribbon Task Force, comprised of private sector volunteers, to conduct a six-month review of the District's business practices and operational policies. The creation of the Task Force was motivated by concerns that Metropolitan did not enjoy sufficient public support, the perceived low general understanding of the District's role in providing wholesale water supplies to Southern California, and a desire to enlist the private sector to obtain fresh perspectives about the MWD's business practices and identify new solutions to problems that might exist.

Members of the Board, member agencies, and other interested individuals subsequently nominated 124 community leaders to serve on the Task Force. On June 14, 1993, the Executive Committee of the Board selected 33 people from the overall list of nominees to be invited to form the Task Force. Twenty-seven individuals eventually accepted invitations to undertake the effort, and, at the request of the Board, Nelson Rising, Senior Partner of Maguire Thomas Partners, agreed to serve as the Chair.

The Task Force first met on July 28, 1993. After considerable discussion, technical briefings, and additional meetings, four working subcommittees were created: (1) Integrated Resources Planning (IRP) and Rate Structures, chaired by Raymond L. Orbach, Chancellor, University of California, Riverside; (2) External Relations, chaired by Beth Rogers, Managing Partner, Pacific Earth Resources; (3) Business Practices, chaired by Jacques Yeager, Sr., President, E.L. Yeager Construction Co., Inc.; and (4) Human Resources and Diversity, co-chaired by Bondie Gambrell, President, Forty Acres Real Estate Company and Patty DeDominic, President, PDQ Personnel Services, Inc.

After the organizational structure of the Task Force was established, the Board approved a budget for the effort, an executive director was selected, and each Subcommittee secured outside

consultant assistance as necessary to complete its review. The Task Force met several times in executive, plenary and Subcommittee sessions during August-December, 1993 to develop a set of findings and a series of recommendations for the Board's consideration in each area of concern.

This Report details the results of the Task Force's examination of several substantive areas within the MWD, all of which were undergoing rapid change. Functioning as a "citizen's committee" of private-sector individuals concerned about water issues in Southern California, the Task Force evaluated Metropolitan's processes for reaching fundamental resource and policy decisions, and its general business and personnel practices.

From the outset, the Task Force Report recognized that it could not, and did not want to serve as an outside auditor or management consultant for Metropolitan. Rather than focus on complex statistical issues or intricate policy debates, the findings and recommendations presented in this Report are intended to signal general areas that the volunteer members of the Task Force, after several months of study, believe merit additional Board and MWD staff attention. It is hoped that concerned readers will look beyond potential disagreements over comparatively minor matters and treat the broad themes developed in the Report as an invaluable barometer of public concern in an era when public understanding and support is increasingly critical to Metropolitan's mission.

The Metropolitan Board of Directors demonstrated considerable initiative and confidence in requesting this first-ever comprehensive, outside assessment of the District's activities. The goal of the Report is to assist Metropolitan continue its remarkable level of service to the people of Southern California in providing reliable, affordable wholesale water supplies during the currently challenging times in the water industry.

The Metropolitan Water District Blue Ribbon Task Force

Executive Committee Members and Subcommittee Chairs

Nelson Rising, Senior Partner, Maguire Thomas Partners
Task Force Chair

Raymond L. Orbach, Chancellor, U.C. Riverside
Chair, IRP/Rate Structures Subcommittee

Beth Rogers, Managing Partner, Pacific Earth Resources
Chair, External Relations Subcommittee

Jacques S. Yeager, President, E.L. Yeager Construction Co., Inc.
Chair, Business Practices Subcommittee

Bondie Gambrell, President, Forty Acres Real Estate Co.
Co-chair, Human Resources and Diversity Subcommittee

Patty DeDominic, President, PDQ Personnel Services, Inc.
Co-chair, Human Resources and Diversity Subcommittee

IRP/Rate Structure Subcommittee Members

Donald F. McIntyre, President, Central City Association
of Los Angeles

Donald W. Reeder, Manager, Pro-Ag, Inc.

Ralph R. Pesqueira, El Indio Restaurants

Paul C. Hudson, President, Broadway Federal Savings

Warren Henry, President, Henry Avocado Packing Co.

Linda LeGerrette, Priceless Events

Gary Hunt, Executive Vice President, The Irvine Company

External Relations Subcommittee Members

Billie Curry Greer, President, Greer/Dailey, Inc.

Jerry Cremins, President, State Building and
Construction Trades Council

Stewart Kwoh, Executive Director
Asia-Pacific American Legal Center of Southern California

Business Practices Subcommittee Members

Roberta J. Spoon, Brodshatzer, Wallace, Spoon & Yip

Larry M. Seigel, Partner, Ernst & Young

Dennis C. Poulsen, President and CEO, Rose Hills Co.

J. Nick Baker, President, One Central Bank

John Cardis, Managing Partner, Deloitte & Touche

Roy Cardona

Gilbert T. Ray, O'Melveny & Meyers

Human Resources and Diversity Subcommittee Members

Richard M. Brown, President, California Angels

Fred Y. M. Chen, President, MAA Engineering Consultants, Inc.

Phillip J. Pace, President, PACE Development Co.

Blue Ribbon Task Force Executive Director

David Friedman, Tuttle & Taylor

Subcommittee Consultants

Lloyd Dixon, RAND, IRP and Rate Structures
Michael Hanemann, U.C. Berkeley, IRP and Rate Structures
Michael Beck, U.C. Riverside, IRP and Rate Structures
West Directions, External Relations
Arroyo Seco Associates, Inc., Business Practices
Arthur Anderson & Co., Business Practices
Ron McCoy, Business Practices
Karo Enterprises, Human Resources and Diversity
Golden State Management Services,
Human Resources and
Diversity

Introduction

Metropolitan's Strategic Challenges and The Task Force Report

From its inception in 1928, the Metropolitan Water District (Metropolitan or the MWD) has established an enviable record of reliability, unsurpassed engineering quality, and public service while providing Southern Californians with the wholesale water supplies on which their livelihoods depend. As the largest water district of its kind in the world, Metropolitan's many achievements include the construction of the Colorado River Aqueduct and a key role in the continuous expansion and improvement of the California State Water Project. The MWD's importance to our region's social and economic vitality is further exemplified by its status as the anchor financial rating institution in the western United States.

Unlike more stable, earlier periods, Metropolitan's mission and operational practices are now subject to extensive reappraisal. Chief among its new challenges is intensified competition for California's scarce water resources, as burgeoning demands for agricultural, industrial, urban and environmental water—and the prolonged recent drought—generate ever-more painful allocation decisions, and as the state's Colorado River rights are reduced. These supply concerns are exacerbated by the still-unresolved problem of transporting State Water Project flows through the Sacramento and San Joaquin Delta, and increasingly stringent federal and state water quality standards. At the same time, Metropolitan faces intensified demands for social diversity, environmental sensitivity, and regional growth coordination that profoundly affect how it defines and carries out its functions.

All of these challenges make the MWD's task of providing reliable wholesale water supplies at a price its customers can afford increasingly difficult. In response, Metropolitan has initiated several measures, many of which are unprecedented since its formation in 1928:

- *Proposed major capital improvement program.* Metropolitan is poised to begin a major capital improvement program, valued at close to \$6 billion. The centerpieces of the program—and nearly half its cost—are the Domenigoni Reservoir and Inland Feeder projects, designed to increase local water storage flexibility, insure against inter-mountain supply disruptions, link the East Branch of the State Water Project to the Colorado River Aqueduct to enhance water quality and delivery capabilities, and facilitate better system maintenance.
- *New key management and Board personnel.* Metropolitan has recently hired a new General Manager and General Counsel, and is continuing its search for a Personnel Director. Half of the MWD's Division Managers are new to their positions within the last year. In December, a new Chair and officers were elected to head the MWD Board of Directors, which has itself experienced more than a 70% membership turnover in the last three years.
- *Novel water transfer legislation and transactions.* The MWD was instrumental in securing legislation permitting water transfers from the federal Central Valley Project, and it continues to press for similar measures regarding State Water Project supplies. Metropolitan is completing the first-ever contract to purchase water from a Central Valley Project contractor under the authority of the Central Valley Project Improvement Act.
- *Outreach to member agencies.* Under the direction of the new General Manager, Metropolitan has taken steps to involve member agencies more fully in its decision making, including a novel "American Assembly" which, for the first time ever, brought MWD, Board, and member agency staff together to discuss major strategic issues.
- *Commitment to diversity.* In recent hearings and other public communications, Metropolitan has made

particularly strong commitments to diversify its staff and ambitious affirmative action and minority/women owned business enterprise contracting objectives.

- *Outside reviews.* Over the past several months, the Metropolitan Board and management staff have initiated two unprecedented reviews of the MWD's operations by public, independent entities, the Operations and Engineering Peer Review, and the Blue Ribbon Task Force.
- *Completion of the first-ever MWD senior management retreat to stimulate staff and interagency coordination.*
- *Completion by the Board and Senior Management in 1993 of the first-ever Metropolitan Strategic Plan.*
- *Initiation of a novel integrated resources planning effort, including the involvement of member agency managers, to define Metropolitan's future operational objectives.*
- *Development and partial Board approval of innovative rate structure revisions designed to rationalize Metropolitan's revenue stream with respect to its fixed and variable costs.*

In general, the Task Force was impressed with the MWD's professionalism and dedication to the people of Southern California and the State. The fact that the Board of Directors initiated this review of the MWD's activities reflects considerable foresight and self-confidence. In most areas of concern, Metropolitan has already begun positive responses or is planning corrective measures. The Task Force applauds the MWD's achievements and its efforts to identify and solve its problem areas.

The purposes of this Report are to:

(1) underscore the necessity for Metropolitan to maintain—and, in some cases, substantially enhance—its ongoing responses to new and difficult challenges;

(2) discuss current and potential problems with certain Metropolitan strategies and provide positive corrective suggestions; and

(3) identify additional areas of concern that Metropolitan has yet to explicitly consider, and provide recommendations for addressing them.

This Report is comprised of five parts: Part I, Integrated Resources Planning and Rate Structures; Part II, External Relations; Part III, Business Practices; Part IV, Human Resources and Diversity; and Part V, Issues Not Addressed in this Report.

The first two parts examine many of the long-range planning and governance issues confronting Metropolitan. Their major theme is that in the current and reasonably foreseeable future, the MWD cannot function simply as a utility providing engineering solutions to Southern California's water supply, distribution, and quality challenges. Metropolitan must instead continue its ongoing evolution into a regional, if not state-wide governance organization to generate creative solutions to existing and future water issues, and then help build the alliances and consensus necessary to realize outcomes that best serve the public interest.

Parts III and IV assess Metropolitan's progress in improving its most important management, personnel and operational functions. The Task Force found that Metropolitan has made substantial improvements, but that much work remains to be done in several specific areas.

Part V briefly considers several matters that the Task Force considers of importance for Metropolitan's future success, but which were not explicitly addressed in this Report.

Part I: Integrated Resources Planning and Rate Structure Proposals

After several years of limited system improvements and comparatively stable water rates, Metropolitan is once again planning several major construction projects, activities which will almost certainly require substantial rate increases or other revenue enhancements. The MWD has instituted two innovative procedures to identify its capital investment goals and the best means for achieving them: Integrated Resources Planning (IRP) and rate structure proposals. The Task Force believes that supporting and expanding the scope of Metropolitan's current IRP and rate structure initiatives are critically important if the organization is to meet its objectives and continue to serve the public interest.

Four aspects of Metropolitan's IRP and rate structure activities were examined—(1) the integration of both efforts with MWD's overall decision making process, (2) IRP planning techniques, (3) rate structure proposal issues, and (4) regional and statewide water policy governance concerns.

1. The IRP/Rate Structure Process and MWD Decision Making.

A. Findings

Current demand and supply volatility makes defining MWD's optimal water resource mix much more complex than in the past. Each combination of potential resources generates a different set of supply, water quality, project cost, and member agency burden-sharing risks. The MWD's IRP process began with the Board establishing specific reliability and supply objectives. Then, with such goals in mind, the IRP sought to find the most appropriate mix of water sources—including imported water, local groundwater supplies, conservation and best management practice techniques, reclamation, desalination, and water transfers from the State Water

and Central Valley Projects—and system improvements that could realize its objectives.

MWD's rate structure proposals address concerns that as MWD embarks on the capital improvement program or other ambitious construction efforts, it will incur vastly increased fixed costs arising from the expense of bond financing to pay for capital expenditures. These debt service charges would be added to the MWD's already substantial fixed obligations arising from its State Water Project commitments—Metropolitan's contract with the State requires it to pay a greater amount per acre foot than originally anticipated without enforceable delivery guarantees—and recurring maintenance and administration charges. Metropolitan's additional cost burdens were projected in 1991 to increase the wholesale price of water from approximately \$200 to close to \$700 per acre foot, a level that could seriously undermine demand for Metropolitan water. In addition, the drought increased member agency awareness of other, non-MWD sources of supply, such as reclamation, conservation and water markets.

Since raising *ad valorem* property taxes is not currently being considered, MWD would increasingly be forced to cover its fixed costs with variable revenue sources, largely through increased water sales income. At the same time, increased water rates would likely decrease member agency demand for MWD water, which in turn would reduce income—and possibly the need for some capital programs. Metropolitan's proposed new rate structures attempt to increase member agency fixed payments to cover fixed MWD expenses independent of the volume of water the agencies purchase, but, as discussed in Part I.3 below, do not yet sufficiently resolve this crucial issue and fail to recognize the dampening effect higher prices will likely have on water demand.

The IRP and rate structure proposals were initially conceived as comparatively simply engineering and financial exercises. IRP would set the system-wide plumbing, storage, local project development and other "hardware" parameters required to meet certain reliability or quality goals. A new rate structure would establish the best way to pay for the resulting improvements.

In practice, both have become much more sophisticated, politically sensitive efforts and are intimately intertwined. Most participants now recognize that there is a range of possible solutions that ultimately depend on the degree to which interagency consensus-building, and influence at the state and federal level, can be achieved. The implications of this evolution are discussed in Part I.4, and Part II, below.

At present, the relationship between the IRP and actual MWD engineering and project decision making is ambiguous, partially due to the problem of coordinating ongoing, Board-approved construction projects with the IRP process. Prior to IRP completion, in accordance with approved plans, the MWD has spent at least \$200 million in improvements at the Domenigoni Reservoir project site, begun blasting apart a mountain for the required dam landfill, and released press statements heralding the imminent construction of an 800,000 acre foot storage facility—the largest possible configuration. Since the scale, timing and desirability of such projects as the Domenigoni Reservoir are now subject to IRP review—which may conclude that certain currently planned initiatives are too costly or that better alternatives for meeting operational objectives exist—there is a latent tension between the IRP and existing capital improvement priorities that the MWD has previously developed.

The IRP and rate structure efforts are also not yet fully integrated, although the Strategic Plan commits the MWD to linking both efforts. The same MWD staff and member agency representatives are involved in both the IRP and rate structure initiatives, but each is proceeding somewhat independently from the other. The Board recently approved a new rate structure for 1995-96, for example, that will generate fixed revenues to amortize capital improvement program debt expenses before the extent and scope of these projects—and their cost—has been determined by the IRP process.

As a result, IRP participants are in effect being asked to define future operational and resource objectives without at the same time directly considering the costs or revenue stream implications of the choices they will make. Discussions over possible rate structure revisions amount to setting prices for water, construction and other

MWD services before the quality and volume of such "products" has been defined through the IRP. Further, the impact of new rate structures on MWD investment and member agency water purchase and investment decisions has been overlooked.

In the past, major policy decisions have been undertaken by the MWD with largely informal member agency coordination. Although both the IRP and rate structure efforts directly involve member agencies in setting functional objectives, performance standards and the development of background materials such as the Strategic Resources Assessment—and to some extent, other outside participants—the precise role of non-MWD participation in IRP and rate structure discussions often seems limited to commenting on Metropolitan-generated objectives rather than considering *de novo* functional objectives and performance standards.

B. Recommendations.

- *The IRP process should actually govern MWD engineering, investment and operational decisions.* To effectively establish MWD's future priorities, the IRP should unambiguously be the central planning process for the organization, not an "exercise" subject to revision, or rejection, as Metropolitan staff sees fit. Major investment projects, including the Inland Feeder and Domenigoni Reservoir, should not be undertaken independently from the IRP. Unless the IRP participants clearly understand that their choices will have real consequences for MWD and the region's water policy, they will have no incentive to carefully appraise their options, revise the IRP process as necessary, and develop a strategy that can reliably guide Metropolitan's future decision making.
- *The IRP and rate structure proposals should be formally, and functionally, integrated.* Metropolitan must explicitly link IRP system choices to the cost and risk commitments member agencies must make when considering various rate structure proposals. This requirement goes beyond simply designating the same personnel for both activities,

but instead involves a closely coordinated effort in which member agencies' willingness to pay sets operational and system limitations for the IRP, and resource choices are continuously factored into revenue enhancement decisions.

- *Reliability, quality and other water supply specifications cannot be made independently from the willingness of MWD customers to pay for such services.* Member agencies may want, for example, the insurance provided by major investments to increase MWD standby capacity, but if forced to commit funds for such capabilities, they may actually prefer far lower levels of protection than a hypothetically "costless" water supply guarantee.
- *Member agency and other external participants in the IRP and rate structure process should have an unequivocal role in shaping the outcome.* Building a consensus on the future system parameters MWD's customers desire, and the amount they are willing to pay to achieve these goals, is Metropolitan's greatest challenge. Member agency and other appropriate consumer participation is therefore critical in the IRP and rate structure process, and the decisions these external actors help to make should unambiguously control the results.
- *Baseline reliability objectives should be revisited as alternative resource and cost scenarios are developed and not treated as fixed elements of MWD's planning process.* Failure to recognize the effects that dramatically increased water rates will likely have on the demand for water may invalidate the justification for some capital program expenditures. Reliability, cost and demand are all interdependent and should be treated that way in the IRP and rate structure reform processes.

2. The Integrated Resources Planning (IRP) process.

A. Findings.

The IRP process is a pioneering step in regional and California water policy planning. There are several issues the MWD should consider as the effort evolves.

The extent to which Metropolitan can obtain comprehensive agreements from appropriate water agencies about such matters as groundwater management will likely affect the scope of construction projects and other investments it must make to meet its operational goals. At present, agency coordination is not adequately modelled in the IRP. The possibility, for example, that major Southern California reservoir projects might be scaled back if the agencies that control surplus groundwater storage reserves coordinate their activities is not explicitly incorporated into any IRP planning scenario.

The IRP also generally assumes a static political environment affecting possible MWD water supplies and other operational concerns. Politically-sensitive decisions, such as access to the Colorado, new environmental or other water set-asides, quality standards, or modifying MWD's (currently heavy) State Water Project financial burdens can have a substantial effect on Metropolitan's potential resource mix and water supply reliability. Mounting major political efforts to influence outcomes relating to such crucial issues is not, however, considered an integral strategic option in the IRP.

Several water supply sources, such as Central Valley Project and other water transfers, are treated as residual factors in the IRP, and not part of the primary resource mix. The IRP estimates total "conventional" supplies from anticipated demand. Any shortfall is assumed to be filled by water transfers or other non-traditional sources. This treatment may understate the potential size and scope of new resources and focus attention on a more limited range of options for future water supply management.

The IRP estimates of total water demand are based on a static model that is used to project per capita water use and then combined with population growth and land use forecasts provided by outside agencies. The model is based on past behavior and may not describe the true range of future options. Further, the IRP analyses that are derived from the water demand models do not adequately consider the potential effects of cost increases, lifestyle changes, enhanced conservation technologies, and other factors on regional water use. The MWD itself has an influence on future Southern California population expansion and development patterns (such as lot sizes and landscaping practices) because of its pricing and supply capabilities. These fundamental relationships are not addressed in the IRP.

Several operational and other requirements are not explicitly factored into the costs associated with various MWD resource mixes. Although tightening federal and state standards have required substantial filtration and R&D expenditures by MWD, and affect the way that water can be used for groundwater replenishment and residential use, water quality expenses are not presently considered in achieving the IRP resource mix.

The IRP also assumes that "Best Management Practices" and local resource investments such as reclamation, will be limited in scope and not require substantial expenditures to achieve. Implementing Best Management Practices standards and building local water recycling or other capabilities requires MWD and agency expenditures that should explicitly be considered as part of the overall costs needed to realize a desired water supply.

The IRP was originally designed primarily as a one-time effort to set construction and service priorities for several years in the future. Current plans envision follow-on sessions but these have yet to be clearly defined in scope and time. The emphasis on the current planning process and lack of a fixed follow-on effort may encourage investments that might be better deferred, modified, or even scrapped as future demand, supply or other circumstances deviate from the plan's initial assumptions. A more flexible approach would be to treat current resource mix and reliability goals as approximations of future requirements, and distinguish priority

from less imperative projects useful more for insurance than to meet current problems. Planned outlays and operational goals would then be reassessed at regular intervals to re-establish priority and staggered investments for the following period until the next plan review is conducted.

Metropolitan's IRP process begins by establishing reliability and service standards, and then attempts to develop the least costly, most effective resource mix that will meet its goals. Another approach would be to start with the amount member agencies are willing to pay for system-wide improvements over a period of time, and derive from that figure the maximum reliability and performance capabilities MWD can afford to make. At present, these two methods will likely generate widely divergent results because the IRP does not adequately reexamine the reliability and other baseline assumptions affecting resource mix debates. If the IRP results are valid, each method should reasonably approximate the results of the other.

As different resource, reliability and operational goals are considered, IRP participants are not presented with fully articulated alternative models. The current practice is to make marginal changes in an assumed base resource mix in response to new cost, technological, political or other concerns. This practice may limit the participants' understanding about the implications of different options, and artificially constrain the range of choices they take into account.

B. Recommendations.

- *Explicitly model the relationship between resource choices and various cooperative regional water management agreements. As part of the IRP, MWD should explicitly model a range of inter-agency water use and storage agreements, including groundwater management, from a "no agreement" baseline to much more cooperative arrangements, to illustrate the relationship between member and other appropriate agency collaboration and MWD operational goals, resource mix options, and costs. The coordination of member, non-member and*

sub-agency water policies and programs will affect regional water resource costs and reliability, and Metropolitan's functional scope and responsibility.

- *Incorporate political factors into the IRP.* The IRP should expressly consider whether committing resources to obtain more favorable legal results—securing federal guarantees for maximum Colorado River Aqueduct utilization, for example, or working in Sacramento to reduce State Water Project financial obligations or strengthen the Project's delivery guarantees—makes sense as part of Metropolitan's long term strategies.
- *Water transfer supply resources should be actively incorporated into the potential resource mix.* The IRP should explicitly consider the costs and benefits associated with securing major water transfers rather than treat such supplies as residual or secondary resources. The environmental and economic impacts to the regions from which water rights are purchased should be part of the planning process.
- *Water demand variations should be less static.* The IRP should develop a range of demand levels considering the potential effects of such factors as future price increases, coordinated regional growth management strategies, new development charges, and enhanced delivery and conservation technologies on regional water use. In particular, Metropolitan's own impacts on baseline population, development patterns, and water use levels should be explicitly considered.
- *Water quality should be factored in as an explicit cost.* The IRP should explicitly consider options and costs associated with achieving water quality standards compliance, and the system-wide implications for delivering or procuring filtered and unfiltered water with the willingness of member agencies to pay for such options. In addition, the MWD should evaluate the benefits and costs associated with expanded parallel

distribution systems to provide untreated or grey water supplies for uses that do not require filtered, treated water.

- *Costs associated with Best Management Practices and local projects should be clearly established and evaluated.* The IRP should flexibly assess the costs and benefits of achieving Best Management Practices and local project subsidies, and broaden the extent to which these components of the IRP might vary as part of the regional resource mix.
- *Continuously stagger and reassess investment needs.* The IRP should consider staggering investments over a period of time to evaluate whether the predicted requirements in fact materialize. At regular intervals, the timing and scope of planned investments should be reassessed and modified as circumstances warrant.
- *Derive IRP results starting from a willingness to pay perspective as well as from reliability and supply goals to assess whether current planning efforts adequately "loop back" and force the reappraisal of initial reliability and other operational assumptions.* Member agencies, and other water users, may have a desire to improve reliability and performance capabilities beyond their willingness or ability to pay for such improvements. In the event of substantial divergences in various water users' willingness to pay for MWD capacities, Metropolitan may wish to consider more flexibly pricing wholesale water supplies to reflect the levels of reliability and cost burdens that each user desires and is willing to bear. Effective planning can only occur after the maximum level of current and future investment member agencies will bear has been determined.
- *Educate IRP participants by modelling alternative future scenarios more clearly rather than make marginal modifications to the baseline scenario.*

- *As part of the IRP process, the MWD should consider developing coordination agreements with member and other relevant agencies that have extensive groundwater basins that could be used by the MWD to increase storage. Incentive programs should be established wherever useful and feasible to compensate member and other groundwater agencies for storing MWD water for future use by Metropolitan.*
- *The MWD must continue to develop planning and pricing policy relationships with its member agencies. Involvement by the member agencies in MWD planning should not be limited to mere representation through the MWD Board membership, but through explicit communication channels with member agency personnel. Where appropriate—in groundwater management, for example—non-member water agencies should also be part of the planning process.*
- *The MWD should assure that the IRP process actively considers overall "public benefits." The IRP planning process could limit growth and stifle economic development instead of enhancing these goals unless linked to a basic sense of which outcomes best generate overall public benefits and welfare. Defining such standards, and integrating them into the IRP process should therefore be an integral part of the MWD's planning agenda.*

3. The Rate Structure Proposals

A. Findings

An effective rate structure should generate sufficiently stable revenues to cover fixed costs, and stimulate careful consideration of the costs and benefits associated with capital projects, alternative water supplies, and consumption. Metropolitan's proposals recognize and address these issues, but several potential problems remain.

The proposed rate structures primarily create two new obligations on member agencies, a Readiness to Serve Charge and a New Demand Charge. The Readiness to Serve Charge is intended to provide stable revenue to cover the fixed costs associated with the capital improvement projects to meet existing users' untreated water quality and reliability needs. The New Demand Charge would shift the costs of increased system capacity to the users that generate the new demands on MWD.

As the concept has evolved, each member agency will eventually pay a Readiness to Serve Charge based on its average MWD water purchases over the previous four years. The amount of revenue anticipated from current Readiness to Serve Charge proposals appears to be much less than the anticipated fixed costs associated with a fully implemented capital improvement program.

Worse, as year-to-year water use changes for each agency, some will bear more of the Readiness to Serve Charge burden, and others less, depending on each agency's desire and ability to utilize alternatives to MWD supplies. To reduce the range of Readiness to Serve Charge burden shifting, MWD's proposals would limit the reduction any one agency could achieve to 50% of its 1989-93 consumption levels. This limitation still permits dramatic variations from initial Readiness to Serve Charge commitments. Some member agencies—especially those with a number of water supply alternatives—may not adequately weigh the costs and benefits of proposed projects at the outset.

The New Demand Charge also does not yet require up-front agency commitments. Under current proposals, MWD could still initiate projects on its own, and only when demand actually increases above a baseline amount would the agencies that require and benefit from the new capacity actually have to pay for such improvements. The timing, scope and extent of New Demand Charge investments and payments are not synchronized, forcing Metropolitan to unilaterally forecast future demand and initiate projects, rather than secure up-front commitments from agencies that want additional system capacity improvements. This strategy commits current resources without guaranteeing the future revenues to pay for new investments.

An additional problem with the New Demand Charge is that the definition of current versus "new" capacity expenditures could severely harm future development and economic vitality if not carefully assessed. Current users—which control the Board—will have incentives to define new and future capacity investments in ways that may shift the costs of system improvements that actually benefit both current and future consumers exclusively onto future users. Such a result could negatively affect Southern California's economic development options.

MWD's proposals will also modify its basic water sales rates. As an increasing amount of revenue is obtained from fixed commitments like the Readiness to Serve and New Demand Charges, the variable unit price of wholesale water sales will fall (although the total cost of water to the end user will increase significantly when fixed charges are factored into the price). This may cause variable water rates to deviate substantially from real marginal costs, even though member agencies are likely to derive their retail or secondary wholesale prices from a combination of the fixed and variable water charges they pay.

The recent rate structure revisions also create a new peaking charge to recover the operational and capital costs associated with customer demand spikes during periods of low water supplies. The present level of the peaking charge—\$6 million—is not yet adequate to cover the actual costs of customer peaking, but rather reflects the member agencies' desire for a period of phased-in implementation of the new expense.

MWD has not proposed revisions to its drought allocation policy, the Incremental Interruption and Conservation Plan. At present, in drought emergencies, member agencies are given an allotment based on their 1989-90 share of total MWD consumption, and charged a higher amount for purchases above their allocated levels. If member agencies in fact do cut back consumption below the base allocation, as was the case in the early 1990s, MWD may not generate enough revenue to cover its fixed and drought-related costs, necessitating future, substantial rate increases. Should this

occur, public support for conservation and trust in Metropolitan may fall.

The new rate structures also do not address the severe problems many water-dependent industries are experiencing as Metropolitan water rates climb. Agriculture in the MWD service area, for example, which consumes about 5% of Metropolitan's overall water deliveries, is being severely hurt by escalating water costs and the risk of service interruptions. Throughout the region, but especially in areas like San Diego, where the delivery of untreated MWD water supplies is limited, growers frequently must pay the highest MWD treated water rates. Yet—together with other uses such as direct and in lieu replenishment and sea water barrier programs—they receive the lowest delivery priority during shortages.

Already high, dramatically escalating water costs and uncertain supplies are causing many long-term, productive groves and farms to be retired, and are also adversely affecting other horticultural activities, such as nurseries, that generate substantial urban revenues and employment. Despite the economic and social consequences of the Southern California agricultural retrenchment, there is no systematic analysis, let alone creative mitigation of water pricing and service concerns.

Currently, MWD pays a fixed fee of \$154 per acre foot for approved member agency reclamation projects, and a varying amount up to \$250 per acre foot for groundwater recovery efforts. The real value of such local projects to Metropolitan in fact varies substantially with water availability. The rate structure proposals do not effectively approximate Metropolitan's real marginal and avoided local project costs over time. As resource options change, this deficiency does not encourage the optimal integration of water resources.

In December, 1993, the Board approved several new categories of rate charges that will be gradually imposed in later years. The Board deferred the imposition of Readiness to Serve or New Demand Charges in 1993-94 and voted instead to extend the increase in parcel taxes that had been imposed in 1993-94 for 1994-

95. This "standby charge" will raise approximately \$50 million to cover estimated capital improvement program expenses associated with meeting certain continuing—as opposed to future—service requirements (even though the IRP process has yet to define the MWD's capital investment priorities). Water rates will also rise by about 6.5%.

For 1995-96, the Board agreed to abolish the parcel tax standby charge in favor of a Readiness to Serve Charge that will generate approximately \$66 million per year, an amount the MWD believes to be equal to the anticipated debt service generated by capital improvement program costs attributable to maintaining existing untreated water system capacity. These estimates, however, have been made prior to the clarification of actual MWD capital improvement program objectives in the ongoing IRP process. A New Demand Charge is also slated to be imposed in 1996-97, well after many capital improvements affecting increased capacity will likely have been initiated. The Board also requested from the MWD staff several studies of demand charge and seasonal storage options, the impacts on Metropolitan of agency water use variation, and local project sensitivity to rate changes.

Securing member agency commitments to pay for new categories of fixed charges as specified in the revised rate structures is a considerable achievement for the Board and MWD staff. The current challenge is to closely coordinate the further definition of the precise burden, form, and method of payment of the new charges with the IRP process in an interactive manner (see Part I.1 and Part I.2, above) so that costs and system improvements are simultaneously determined.

It is not sufficient for the IRP to simply generate system specifications, and then to use these results to mechanically determine the amount in each new category of charges that the member agencies will have to pay. The goal of the IRP and rate structure efforts is to assure reliable water supplies at a price that Southern California businesses and consumers can afford. This can only be achieved by continually weighing system improvement objectives against specific cost burdens at the wholesale and retail levels, an objective that will require close, and continuous linkage

between both the IRP and rate structure efforts. A failure to adequately cover capital improvement program fixed debt burdens, or ambiguity in the method of funding such obligations, can also adversely impair the MWD's financial base.

B. Recommendations.

- *The MWD's new rate structures should ensure adequate coverage of the fixed commitments for projects that generate additional fixed costs for Metropolitan. To force MWD's member agencies and other water consumers to price, rationally appraise, and commit to new construction, rate structures like the Readiness to Serve and New Demand Charges should be sufficient to cover the full fixed expense of new projects without substantial modifications based on water use or other variable factors. Implementing this policy may require MWD to allocate rights in its water supplies to member agencies based on their fixed payment commitments.*
- *If a comprehensive Readiness to Serve and New Development pricing scheme is implemented, secondary markets should be established by the MWD to allow the transfer of member agency excess water entitlements to other users that may need additional water supplies. A secondary market for the water entitlements created by a Readiness to Serve and New Demand Charge system would provide member agencies with a mechanism to reduce their fixed commitments to the MWD by selling the water entitlements for which they have no need. Conversely, MWD customers that may require additional supplies could obtain them through such secondary market purchases, avoid paying new development charges, and reduce pressure on the MWD for additional system expansion.*
- *If current proposals cannot adequately address the MWD's revenue and pricing challenges, then alternative rate structure revisions should be explored, such as using higher variable water rates to increase the rate*

stabilization fund and cover fixed costs, or creatively utilizing ad valorem or other fixed revenue enhancements. As at least a short-term alternative in the event effective Readiness to Serve and New Demand Charges cannot be established, the MWD should consider modifying its current water prices to build a reserve for its fixed cost coverage. While rates may slightly rise if sales fall, in general this strategy would more accurately cause water prices to reflect the marginal cost to MWD, inclusive of capital investments, and therefore encourage more efficient water allocation. An additional alternative may be to utilize *ad valorem* parcel or other fixed revenue sources more flexibly, including comparatively novel arrangements in which certain agencies may elect to pay property taxes, Readiness to Serve Charges, New Demand Charges or higher variable water rates according to their individual preferences and requirements.

- *The peaking charge should recover the actual economic costs generated by peaking behavior and not be set by political considerations.*
- *MWD rate structure proposals should revise and improve the emergency allocation programs and local project pricing schemes to reflect MWD's real marginal and avoided costs and revenue requirements.*
- *Comprehensive rate structure revisions should not be further delayed, and pressing MWD revenue needs should be addressed as soon as possible.*
- *In coordination with member agencies and other appropriate water entities, the MWD should explore and implement measures to mitigate the adverse effects of rising water rates on agricultural and other water-dependent industries that do not require the same reliability and water quality as other urban users. The MWD should sponsor efforts to resolve the adverse impact rising water rates and low reliability are having*

on Southern California agriculture and other water-dependent industries to ensure against major job and business losses. Possible solutions include: (1) permitting agriculture to purchase surplus water, when available, at below the MWD's marginal but above its variable cost; (2) the creation of two-tiered rates for certain industrial or agricultural users; or (3) the provision of a "value-added" water rate credit for industrial users that generate jobs and revenues for the community at large.

- *Metropolitan should explicitly seek the optimal integration of water resources through its rate structures since water pricing, in the absence of comprehensive interagency water coordination agreements, is likely to be the most effective tool for some time for selecting among imported water, reclamation, desalting, and other supply options.*

4. Governance.

A. Findings.

Both the IRP and rate structure revision efforts clearly demonstrate the importance of governance issues to MWD's mission. In the past, Metropolitan could plausibly generate system needs internally and adjust rates as required to pay for the improvements. In the current environment, inter-agency coordination is critical to establish the most efficient resource base responsive to the public need, and then secure the funding commitments to pay for necessary investments.

MWD system costs, reliability and supply standards will likely vary considerably with the extent to which member agencies, and other significant water management entities, agree to coordinate regional water management. Comparatively inexpensive options are possible in the event groundwater storage, conservation and emergency use strategies can be regionally integrated. Increased cooperation between MWD and regional water agencies is critical to avoid costly projects, or forcing MWD to construct massive storage and delivery facilities to mitigate potential peaking problems and local supply interruptions.

Governance skills also will determine if MWD can actually pay for its future projects. With bond and property tax revenues limited, and in an era of high business and consumer rate sensitivity, MWD can no longer afford to build major facilities and hope that member agencies will buy enough water to pay for them over several years. The wide variation in member agency local water supply and project options means that each agency will differently value MWD water and facility investments, a fact that can frustrate needed revenue agreements.

The Task Force was troubled to learn, for example, that some of the member agencies most strongly supporting big-ticket projects like the Domenigoni reservoir also had the most aggressive plans to reduce their future MWD water purchases and develop independent supplies. In effect, such agencies appear to want MWD to develop costly backup capacity—or insurance—for their local supply strategies, while seeking to shift the costs for these benefits on to Metropolitan and other agencies and consumers.

Even if a resource and financing strategic consensus could be built among Metropolitan's member and other relevant agencies, the problem of actually realizing the plan's objectives at the consumer level would remain. MWD can attempt to set prices and build facilities to achieve certain levels of consumption or conservation, but its actions will have little effect unless its own agencies, and the consumers that the member agencies themselves serve, price their products and make investments in a consistent fashion. Secondary wholesale and retail charges can double the cost of water to final consumers from MWD price levels. Depending on how these charges are structured at the retail level, Metropolitan's intended price and service incentives may be severely distorted.

As a result, regional governance concerns are at the heart of Metropolitan's planning, pricing, and strategic implementation activities.

Governance is also fundamental to MWD's mission in the larger sense of affecting the political decisions at the state and federal level that will shape Metropolitan's fundamental resource,

financial and utilization options. Southern California faces substantial water supply and distribution challenges that will likely not be seriously discussed, let alone resolved, if not comprehensively reviewed on a regional, statewide, or federal basis. In the contemporary environment, Metropolitan should actively sponsor the regional, statewide and even national discussions necessary to shape its own future and serve the greater public interest.

Similarly, the third-party impacts of many water resource choices and pricing policies are usually not factored into procurement decisions. Water transfers or capacity acquisition charges might benefit certain consumers, but could also harm others, such as the economies of communities from which water transfers take place, or newly developing areas that must bear comparatively high new development water costs. While special interests may effectively advocate their own concerns, the broader public interest may be overlooked.

The Task Force believes that the full range of costs, benefits and social concerns latent in complex water policy issues is not being adequately assessed at either the regional, state, or the federal level. One of Metropolitan's fundamental responsibilities should be to use its considerable influence to help fill this leadership void.

B. Recommendations.

- *Metropolitan should explicitly commit itself to becoming, or building, a regional governance institution facilitating member, groundwater management and retail agency consensus about water policy goals and cooperative management. Management, staff and external relations strategies should be immediately implemented consistent with that objective.*
- *To facilitate regional coordination, Metropolitan should initiate discussions among its member agencies concerning the institutional enhancements that might be required for it to function as a regional governance entity, or to identify other institutional innovations that can accomplish this goal.*