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

February 13, 2012

Board of Directors
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Re: Board Memo 8-2: Authorize the execution and distribution of Remarketing Statement in connection with the remarketing of the Water Revenue Refunding Bonds (Index Mode), 2011 Series A-1 and A-3, in the amount of $128,875,000

Dear Chairman Foley and Board Members,

We have reviewed Board Memo 8-2 including Attachments. For reasons we have described in detail in prior correspondence concerning the sale of bonds by Metropolitan – as well as in recent correspondence regarding the proposed budget (Attachment 1) – we are not comfortable that the Remarketing Statement as drafted by Metropolitan allows us to meet our legal responsibilities in voting to approve the draft Remarketing Statement. We must therefore respectfully vote against the staff recommendation.

We understand the need for the remarketing. And, we acknowledge the edits Metropolitan made in response to our comments on the last draft Appendix A (Attachment 2). However, we do not believe the edits went far enough to ensure that information essential to making an informed investment decision is being presented in a manner that is not misleading. The draft Remarketing Statement does not correct these deficiencies. In summary, the principle (but not exclusive) areas of concern remain the following:

- Failure to sufficiently describe the changed circumstances that have resulted in reduced demand for Metropolitan water.
- Failure to adequately describe the impact on water sales of conservation requirements and higher water rates.
- Risk associated with Metropolitan's inability to secure long term purchase contracts or legal equivalent from its member agencies.
- Risk to Metropolitan of its heavy reliance on water sales revenues to pay its fixed costs.
- Failure to adequately describe the risks and costs associated with uncertainly and volatility of water purchases by City of Los Angeles.
- Risk associated with projecting water sales based on "average" pricing.
- Failure to reasonably estimate future water rate increases, generally, and as associated with Metropolitan's Integrated Resources Plan as adopted by the Board.

- Impact of Proposition 26 on setting water rates and charges.
- Failure to describe impacts resulting from the fact that Metropolitan expenditures have exceeded revenues in three out of the last four years.
- Undue reliance on historical data to predict future outcomes in the current, changed water supply and fiscal environment.

While we are aware and have taken into account that the draft Remarketing Statement includes a number of "disclaimers" in these and other areas, we are concerned that certain of these disclaimers could be challenged because they relate to matters that could or should have reasonably been known by Metropolitan and its Board of Directors.

We do not come to this decision lightly. If Metropolitan and the Board wish to work with us to address our concerns, we will provide detailed comments on the draft Remarketing Statement. We note that we have raised these concerns repeatedly in the context of many different board actions, without receiving a substantive response.

Sincerely,

Lynne Heidel	Keith Lewinger	Fern Steiner	Doug Wilson
Director	Director	Director	Director

cc: Jeffrey Kightlinger, General Manager
Gary Breaux, Chief Financial Officer
San Diego County Water Authority Board of Directors

Attachments:

1. February 3, 2012 letter re: MWD Budget and Rates
2. August 22, 2011 letter re: Appendix A

San Diego County Water Authority
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February 3, 2012

Aaron Grunfeld
Business and Finance Committee Chairman
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

Re: Proposed Biennial Budget and Associated Rates and Charges for 2012/13 and 2013/14

Dear Mr. Grunfeld:

First, we want to thank you for your commitment to hold budget workshops so the board may review, ask questions and understand the proposed budget.

We have reviewed staff's proposed biennial budget and associated rates and charges for 2012/13 and 2013/14, as well as the slides presented at the January workshop. Based on this preliminary review, we are providing you with the comments, requests and questions which are attached. In order to facilitate the board's deliberation of these issues, we request that staff respond to our comments and questions in writing prior to the next budget workshop.

We look forward to continuing this important dialogue at the next budget workshop.

Sincerely,

Lynne Heidel	Keith Lewinger	Fern Steiner	Doug Wilson
Director	Director	Director	Director

Attachment

cc: Jack Foley, MWD Board Chairman
Jeff Kightlinger, MWD General Manager
Gary Breaux, MWD Chief Financial Officer

MWD Budget Workshop #1 – January 24, 2012

San Diego County Water Authority (SDCWA)'s MWD Delegates' questions and comments on proposed biennial budget and associated water rates and charges for FY 2012/13 and 2013/14

All references are to Budget Memo 8-1 for the January 10, 2012 Board meeting or to the power point presentation at the January 24, 2012 budget and rate workshop.

1. ***The Board must take steps to "right-size" MWD in order to ensure that revenues – based on more reasonable demand projections – are sufficient to pay MWD's costs.***

   - MWD's water deliveries declined almost 500,000 acre feet over the last four years from 2.26 million acre feet (MAF) in 2008 to 1.68 MAF in 2012. Moreover, the 2012 delivery figures included 164,000 acre feet of San Diego County Water Authority's (Water Authority) QSA transfer water and 225,000 of "one-time" discounted water sales that would not have occurred at full price. MWD's 2010 Regional Urban Water Management Plan (RUWMP) shows its average year sales in 2030 will be 22% lower than projected in MWD's prior RUWMP just five years ago. MWD's sales projections are flat or trending downward and yet, the Board has taken no meaningful actions, in terms of programs or staffing, to reduce the expense side of the budget to reflect this dramatic reduction in MWD sales.

   - What is basis of budget demand projections assuming full service sales of 1.5 MAF next year and in future years? The Board memo states that the sales estimate is "conservative," yet, this assumption is 200,000 acre feet more than this and last year's full service sales of 1.3 MAF.

   - MWD has not covered its operating costs in six out of the last eight years (2004-2011). The first order of business must be to reduce spending, consistent with budget cuts already implemented by most of the cities and retail agencies in Southern California.

   - Given that retail demand is down 20% or more across the MWD service area, we recommend a moratorium on all subsidy programs designed to further reduce MWD sales (and revenues). The moratorium should remain in place until MWD updates its IRP projections and conducts a comprehensive study to evaluate the need for MWD to pay for such programs. This recommendation should not be interpreted to suggest that the Water Authority does not fully support the development of local supply projects including increased water use efficiency, but rather, that funding should be at the local level.

   - The budget notes that replenishment water will be sold at full service rates, however, it does not appear to account for the cost of "incentives" or "rebates" that are also part of the staff recommendation for a revised replenishment program. Please identify the amount and cost of service category to which these incentives or rebates are assigned. What rate is proposed to generate the revenue to pay the cost of these incentives or rebates?

2. ***MWD should reasonably spread cost burdens among current and future rate payers; it should not raid revenues intended for capital projects to pay operating expenses, and should not overburden future rate payers by deferring OPEB funding.***

   - The budget includes a reduction of PAYGo revenue collections in 2012/13 that is inconsistent with the Board's adopted policy. If the Board approves this recommendation, MWD will have failed to follow its own PAYGo funding policy in eight out of the last ten years (2005-2014). Funding capital projects at such low PAYGo levels unfairly shifts obligations from current

ratepayers to future ratepayers. Moreover, several years of midyear reallocation of PAYGo funds intended for capital to meet operating expenses has distorted cost of service. The Board should not continue to apply revenues that are collected for capital projects to pay operating costs.

- The proposed budget continues to shift a disproportionate share of unfunded OPEB liability to future ratepayers**.** The funding schedule presented at the January workshop to begin ramping up payments to match MWD's Annual Required Contribution (ARC) does not go far enough. MWD should cut costs now in order to increase funding to match its ARC.

- A greater share of MWD's Capital Improvement Program (CIP) now consists of R&R projects. Indeed, the January workshop presentation showed R&R expenditures represent about two-thirds of CIP costs over the two years reviewed. Aside from the misuse of PAYGo to pay operating expenses, we would also suggest that the Board consider changing its PAYGo funding strategy so it is *proportionate* to the total CIP over time. This would ensure that current ratepayers are not being asked to pay a disproportionate share of R&R.

3. *MWD must properly account for the cost of storing water.*

Based on data assembled from the proposed budget, the supply and delivery balance is as followed:

Supply/Demand	2012/13	2013/14
State Water Project (Exchange)* Net to MWD	1,260 TAF (120 TAF) 1,140 TAF	1,140 TAF (108 TAF) 1,032 TAF
Colorado River**	727 TAF	890 TAF
Total supply to MWD service area	1,867, TAF	1,922 TAF
Total MWD demand**	1,700 TAF	1,700 TAF
Excess supply	167 TAF	222 TAF

*The budget document does not describe the exchange; if this is not MWD's exchange obligation with Coachella and Desert Water, please provide details.

**The budget document includes Water Authority's QSA water at 172.7 TAF and 177.7 TAF for 2012/13 and 2013/14, respectively, as both supply and demand. MWD does not report the local water supplies and associated demand of its other member agencies, and has no basis for treating Water Authority's QSA water differently. In accordance with the terms of the Exchange Agreement, the revenues generated from payments made under the Exchange Agreement should be treated as transportation or wheeling revenues.

- Staff reported at the workshop that it plans to store 300,000 acre feet of water this year, which is more water than is estimated to be available for storage in the supply and delivery balance. What is the source of the water staff is planning to store, and, how are the costs of that water captured in the cost of service? How much funding is included in the budget to pay for storage costs? Finally, is the energy cost of moving the water into storage being captured in the System Power Rate or through Supply Programs?

4. ***The cost of service does not recover the costs of system "standby" capacity and supply that enables year-to-year peaking off MWD.***

   - Many agencies peak off the MWD system from year-to-year, depending on hydrology and the availability of local water supplies. MWD has developed and continues to develop water supplies and incur storage and facility costs in order to meet these demands, but is not fully allocating the costs associated with these investments from the agencies that benefit from them. MWD must change its rate structure in order to account for and allocate these costs so that they are borne by the agencies that benefit by being able to peak and then roll off the MWD system.

5. ***The Delta Supply Surcharge should be continued because the purpose for which it was established by the Board has not changed.***

   - Please provide the basis of the staff recommendation to delete the Delta Surcharge. Given the rationale stated in Board Memo Revised 8-3 dated April 14, 2009, the Delta Surcharge should remain in place. In fact, the budget states at page three that increased funding is being included to aggressively pursue exactly the type of projects the Delta Surcharge was intended to cover.

   - Was the Delta Supply Surcharge combined with the Tier 1 supply rate? If not, how were these costs reassigned?

6. ***Staff needs to provide more information why individual rate components are increasing or decreasing; and, take steps to better smooth rate increases at the retail level.***

   - The proposed individual rates and charges include changes that vary significantly from the "average" 7.5% increase staff reports. Since no agency pays "average" rates, information needs to be provided on why individual rates and charges are increasing or decreasing. Please provide the data supporting the System Access Rate increases. Also, please provide the data supporting the supply rate decrease.

   - Staff should also explain why some elements show decreases one year and increases the next year – or vice versa, and, present alternatives to avoid swings in the rates and charges.

7. ***Staff must track all rate component costs and expenditures, not just the Water Stewardship Fund.***

   - MWD tracks over- and under- expenditures for revenues collected under Water Stewardship rate, but not others. What is the basis for this disparate treatment? For example, although MWD has a Treatment Surcharge Rate Stabilization Fund, when fund revenues are insufficient to pay those costs, MWD uses General Fund revenues to cover the difference. The net effect is that raw water customers are subsidizing treated water customers. We request that MWD provide a cost of service analysis for all rate components and identify or develop internal tracking mechanisms to prevent cross-subsidies.

8. ***All operations and staffing should be "right-sized" to reflect reduced demands.***

   - What were staffing levels and budget in 2008? What are they today?
   - What criteria has staff used to "optimize" staffing levels?
   - Are the staffing levels recommended in the budget higher than current actual levels? If so, why?
   - Please provide a list of the O&M association dues that total $5 million annually.

9. ***A contingency plan should be included in the proposed budget.***

   - The biennial budget should include a contingency plan that would automatically be triggered mid-year to reduce *current costs* in the event projected revenues are lower than budgeted.
   - Similarly, the budget should provide a plan that describes in detail how MWD will apply excess funding in the event projected revenues exceed expenditures. This is especially important in light of the recent draw-down of reserves, raids on the PAYGo fund and cross-subsidies that have been created by the failure to track individual rate components – or to budget so that projected revenues are reasonably expected to be sufficient to pay MWD's expenses.

10. ***Even if it is unwilling to update or modify its cost of service analysis generally – which it should – MWD must at a minimum provide a new cost of service analysis to ensure compliance with Proposition 26.***

    - Even If the Board does not require staff to update or modify its cost of service analysis, or, support a moratorium on local projects spending to mitigate the impacts of reduced demands and MWD revenues, staff must identify the benefits it claims are associated with these payments and demonstrate that those benefits are received by those paying the charges and that the amount of the charge is reasonably related to the benefits. The benefits that have been stated but which have not been supported by any data or analysis include (1) capacity will be made available that is otherwise not available for the transportation of MWD water; (2) investments MWD would otherwise need to make in other facilities and/or water supply will be avoided as a result of these payments; and (3) MWD needs and will benefit from the local water supply it is paying for. Please provide the analysis required by Proposition 26.

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August 22, 2011

Board of Directors
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Dear Chairman Foley and Members of the Board:

We have reviewed Appendix A of MWD's Draft Official Statement, distributed to the members of the board on August 15 relating to the upcoming refunding of certain fixed revenue bonds (Draft or Appendix A). While we support MWD's desire to take advantage of the market to reduce its debt obligation, we remain concerned that MWD's financial condition is not accurately described in Appendix A. As you know, the Water Authority's MWD representatives have sent three prior letters regarding Appendix A dated September 22 and December 9, 2010 and May 16, 2011, copies of which are attached as Attachments 1-3, respectively, and incorporated herein by reference. Although MWD made specified changes as described in response letters dated September 23 and December 13, 2010 and email dated May 24, 2011, respectively, we do not believe that MWD has adequately addressed the stated concerns or that the August 15, 2011 Appendix A fairly presents MWD's financial position currently or prospectively. We request that the Draft be modified to address these concerns in order to provide adequate disclosure to potential investors.

The Water Authority has previously raised many of the questions and concerns noted in this letter in prior written communications with MWD. These past communications include but are not limited to letters regarding the budget, dated April 11, 2011; adoption of the Long Term Conservation Plan, dated August 15, 2011; and, Member Agency Willingness to Sign Take-or-Pay Contracts and Request to Correct the Record of July 12, 2011 MWD Board of Directors Meeting, dated August 16, 2011. A copy of each of these letters is attached again for consideration by you and the other members of the board, MWD's management team, General Counsel, outside bond counsel, underwriter's counsel and other members of the financing team (Attachments 4-6, respectively). Unfortunately, MWD has not responded to our letters directly or indirectly by addressing the issues on the merits in changed MWD board policy or management actions.

In addition to the concerns that are described in this past correspondence, which we request you address in your response to this letter, we have the following specific comments on the Draft.

Appendix A, as a whole, fails to adequately describe the financial impacts associated with reduced water sales. Although the Draft discloses that its member agencies are not required to purchase any water from MWD (page 27), the Draft fails to describe the associated risk to MWD, or, its inability to secure long term purchase contracts or other firm financing commitments that are not subject to change by the board of directors to meet its current and future fixed obligations.

Although the Draft includes a section titled, "Regional Water Resources" (beginning at page 27), the

discussion does not make clear what MWD's role is – or is not – in developing local water supplies. Many of the projects noted as "Regional Water Resources" will actually be developed at the local level without any involvement by MWD and, thus, further reduce MWD water sales in the future. The Draft should disclose that local water supplies have become much more cost-competitive as a result of the increasing cost of MWD's imported water and that as a result, many MWD member agencies are now pursuing the development of local water supply alternatives.

The Draft appears to mistakenly rely on past history as an indicator of future MWD sales (page 27) rather than assessing the dramatically changed circumstances confronting MWD.
In addition to the development of local water supplies described above, the escalating cost of MWD water will likely result in reduced sales in the future. The Blue Ribbon Committee Task Force noted this more than 15-years ago. However, MWD continues to present analyses that do not consider the cost of water as a feature that will dampen future water sales. See, for example, Management's Discussion of Historical and Projected Revenues and Expenditures at page 71 (future sales forecasts will reflect "a return to more normal weather conditions, a recovering economy and population growth, *notwithstanding impacts of conservation and projected increases in water rates*" (emphasis added).

Although the state legislature has mandated 20% conservation by 2020, MWD's IRP, recently adopted Long Term Conservation Plan and Appendix A do not describe any impact on MWD water sales. In fact, the Draft states that MWD water sales will return to historic levels at 2 million acre feet beginning in fiscal year 2013-14 "notwithstanding impacts of conservation" (page 71). The Draft should explain how sales are expected to continue at these levels at the same time the retail agencies in the MWD service area are achieving 20% conservation.

Although the Draft discloses the Water Authority's purchase of conserved water from IID and the water it has developed from lining the All-American and Coachella Canals, the Draft describes MWD's transportation of this water under the Exchange Agreement as an MWD water sale. This characterization is misleading and disguises the true fact that MWD water sales have been *reduced* by the amount of water the Water Authority has independently secured from these sources.

The discussion of the Water Supply Allocation Plan (WSAP) (page 26) is also misleading in that it does not state that Preferential Rights is the statutory method for allocating MWD water during a time of shortage. Preferential Rights is discussed briefly much later in the Draft (page 50) but the two topics are not tied together. The discussion of Preferential Rights should also make clear that any "use" of Preferential Rights is at the discretion of the member agencies that hold the rights, not MWD.

The Draft should connect the discussion of Regional Water Resources (beginning at page 27) with the discussion of both MWD revenues (page 41) and Management's Discussion of Historical and Projected Revenues (page70) (Management Opinion). While MWD continues to project returning sales of 2 million acre feet, its discussion of seawater desalination programs alone shows potential reduced sales of almost 400,000 acre feet, exclusive of the many other local water supplies that are now being developed throughout the MWD service territory.

All of the information relating to the sale of discounted water is in the section on resources (page 30). The Draft should be revised to tie this discussion to Revenues (beginning at page 41) and should also be addressed in Management's Opinion. By its own report, MWD chose to sell water at a

discount in part because its member agencies would not pay full service rates for replenishment water. See MWD Board Memo dated May 10, 2011, a copy of which is attached, explaining that MWD water sales would only increase if water is sold at a discount due to the "budgetary or other financial constraints that the member agencies have" (Board Memo at page 3) and that offering water at full service rates would not "significantly increase the demand for replenishment water." And yet, as noted above, the Draft excludes consideration of the impact of the cost of water on future MWD water sales. The Draft should describe how MWD's sale of discounted water reduces full service water sales – reduces water sales revenues – and causes the cost of MWD's full service water to escalate even higher as the true costs are spread among an even lower sales base.

In its May 10, 2011 Board memo recommending the sale of discounted water as replenishment sales, MWD staff asserted that the sales would increase current year (FY 2012) net revenues by $57.8 million (see "Options 3 and 4 Replenishment Service Program," top of page 5). In their ratings reports in May 2011, the rating agencies relied on the promise of additional revenues from replenishment sales to help improve MWD's fiscal position. However, four months into this eight-month discounted water sales period, MWD is not realizing "positive Net Revenue" as the board memo forecast. On the same day MWD staff released this Draft Appendix A for review by the board, our board heard reports in the Finance and Insurance Committee and the Engineering and Operations Committee that, taken together, foretell that the discounted water sales program will result in a net revenue shortfall of approximately $30 million in the current year, assuming 225,000 acre-feet of discounted water is sold by the end of December. In the Business and Finance Committee, the Board was informed that current year water sales are projected to fall short of budget projections by 13,000 acre-feet (assuming a budget based upon 1.8 MAF of sales; the Draft Appendix A says MWD's FY 2012 forecast was for 1.85 MAF of sales). In the Engineering and Operations Committee, the Board was informed that MWD has already sold 118,000 acre-feet of discounted water, and has demands from the member agencies of for 323,600 acre-feet of discounted water. Thus, it appears that projected sales of 1.787 MAF includes assumed sales of 225,000 acre-feet of discounted water. As we warned last May, discounted water sales are cannibalizing full-rate water sales, and will lead to a revenue shortfall this fiscal year of $30 million on the differential alone. This represents a nearly $90 million shift from the MWD staff prediction in May of "positive Net Revenue" of $57.8 million as a result of discounted water sales. MWD is likely to end FY 2012 with yet another revenue shortfall, making it the fourth year out of the past five years in which revenues were not sufficient to cover expenditures.

The Draft should include a discussion and cost estimate for the BDCP and potential impact on water rates. These projected costs of MWD's imported water supplies are the measure by which current decisions are being made to invest in alternative local water supply development and are having an impact now on MWD water sales.

The Draft discloses the ongoing draw down of reserve balances in its discussion of the Capital Investment Plan (page 37), but does not tie these trends into Management's Opinion. The Draft should also disclose the amount of the reserves that are currently held in escrow as a result of the San Diego County Water Authority litigation as well as amounts projected to meet future escrow requirements and the impact this will have on reserve balances.

The Draft should disclose that MWD has had the same external financial auditor for more than 19 years. Further, that a question has been raised regarding MWD's treatment of its State Water

Project contract for accounting purposes (see discussion at page 63).

The Summary of Receipts by Source (page 42) and Summary of Water Sold and Water Sales Receipts (page 43) should disclose receipts for the transportation of water by MWD. Although footnote 3 (page 44) states that "water sales" includes wheeling, the sale of water and the transportation of water are two completely different service functions.

The Draft's Summary of Water Sold and Water Sales Receipts (page 43) also fails to disclose important information by reporting "Average Receipts Per Acre Foot." Since no water is sold by MWD at "average" rates, MWD should disclose the amount of water it sells at full price and under discounted water programs.

The Draft should include a more detailed explanation of current and potential litigation. MWD is on notice of the additional claims the Water Authority intends to file including Rate Structure Integrity, Preferential Rights and Breach of Fiduciary Duty. The Water Authority has also informed MWD that it does not believe that current conservation and Local Resources Programs meet Proposition 26 or other legal requirements. The Water Authority has informed MWD that it does not believe that there is a legal basis for the sale of discounted water to some but not all MWD member agencies. Although the litigation is disclosed in the Draft (discussion of the rate structure at page 45), the litigation should also be noted in the discussion of MWD's Principal Customers (page 49).

Agricultural water sales are discussed in the section entitled, "Classes of Water Service," but should be tied to both Revenues and Management's Opinion on future water sales. The Draft should note that agricultural water sales have historically accounted for as much as 150,000 acre feet or more of MWD's total annual sales, but were less than 35,000 acre feet in 2010. Most of the water sales under the Interim Agricultural Water Program were to customers of the San Diego County Water Authority and are not expected to continue at full service rates when the IAWP terminates on January 1, 2013.

The Draft taken as a whole does not disclose the financial impacts to MWD of significantly reduced future water sales by MWD. The projected sales decline is significant. MWD's 2000 Urban Water Management Plan (UWMP) projected that MWD would sell approximately 2.3 million acre-feet of water in 2020 (average year demand). By the time of its 2005 UWMP, MWD revised the 2020 projection downward to approximately 2 million acre-feet. MWD's 2010 UWMP – adopted nine months ago – again lowered the 2020 projection, this time to 1.66 million acre-feet. In all, MWD's current projected (average year) sales for 2020 are nearly 30 percent lower than it projected just 10 years earlier. The factors contributing to reduced MWD water sales are not accurately described in Appendix A.

The Draft notes in a footnote that disbursements exceeded revenues in the fiscal years ended June 30, 2008, 2010 and 2011. This is a material factor that should be discussed more fully in the Draft and included in Management's Opinion, particularly in light of the likelihood that expenditures will once again exceed revenues in FY 2012.

For the reasons described above and in the Water Authority's letter on the budget (Attachment 4), we do not believe that the projection of MWD's water sales and water rates described in Management's Opinion (page 68) are reasonable. We believe sales will be substantially less than

described and that water rates will be substantially higher than described.

Please contact me if you have any questions.

Sincerely,

Keith Lewinger, on behalf of San Diego County Water Authority
Representatives on the MWD Board of Directors

cc: Jeffrey Kightlinger, General Manager
Thomas DeBaker, Interim Chief Financial Officer
San Diego County Water Authority Board of Directors

Attachments:

1. September 22, 2010 letter re: Appendix A
2. December 9, 2010 letter re: Appendix A
3. May 16, 2011 letter re: Appendix A
4. April 11, 2011 letter re: MWD Budget
5. August 15, 2011 letter re: Adoption of Long Term Conservation Plan
6. August 16, 2011 letter re: Member Agency Willingness to Sign Take-or-Pay Contracts and Request to Correct the Record of July 12, 2011 MWD Board of Directors Meeting
7. MWD Board Memo dated May 10, 2011 re: Sale of Discounted Water

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September 22, 2010

Brian Thomas
Assistant General Manager/Chief Financial Officer
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Dear Brian:

On the afternoon of September 16, you distributed to members of the Board of Directors Appendix A of MWD's Draft Official Statement for an upcoming refunding bond sale and asked for comments to be submitted by noon today; given the tight deadline, we limit our comments in this letter and the attachments to only the most significant issues and concerns with Appendix A. These comments are presented to you by the four of us as directors representing the San Diego County Water Authority. We request that you respond to the questions presented in this letter and make the necessary modifications to Appendix A of the Official Statement before it is finalized and issued. We believe additional time is warranted to schedule a full board review of the issues noted in this letter and in our IRP Comment Letter discussed below.

2010 Integrated Resources Plan

On page A-3, fourth paragraph, MWD makes only passing reference – and does not disclose key facts – about its 2010 Integrated Resources Plan Update. The document states that the IRP "…is expected to be completed in late 2010." In fact, the IRP is expected to be presented by MWD staff to the Board of Directors for adoption at its October 12, 2010 meeting – only 13 days after the initiation of bond sales covered by this Official Statement. Appendix A fails to disclose material facts about the 2010 IRP that should be disclosed to potential investors, including but not limited to MWD's plan to develop so-called "buffer" water supplies in the amount of up to 500,000 acre-feet per year, at a cost of billions of dollars over the next 25 years. On September 10, 2010, the Water Authority submitted to MWD extensive comments on the IRP. A copy of that letter is attached and the questions and comments incorporated herein (IRP Comment Letter). We request that MWD provide a substantive discussion in Appendix A regarding potential legal and financial implications from the shift from MWD's historic role as a supplemental imported water supplier to local water supply developer; that identifies the breadth of the IRP implementation strategies under consideration, and the extent of costs and future water rates that would be necessary to implement the IRP recommendation. Appendix A should also include a discussion – here and elsewhere – on the effects higher water rates are expected to have on MWD sales. Experience over the past several years clearly shows a nexus between sharply higher water

rates and conservation (demand reduction) by customers (ratepayers). MWD should disclose the impacts of its IRP strategies that would lead to water rates exceeding $2,000 an acre-foot by 2035 if not sooner and the impacts increasing water rates would have on water demands on MWD. Further, as discussed at length in the IRP Comment Letter, how will MWD ensure that there will be customers to pay for its regional local water supply projects when so many agencies are in the process of developing local water supply projects of their own for which their retail customers will pay through retail water rates. This concern should also be discussed in connection with the renewal of purchase orders at page A-1.

We are also concerned that the discussion is misleading about the purpose and importance of the IRP in the development and implementation of the "Preferred Resource Mix." Responding to questions about the necessity of CEQA review prior to adoption of the draft IRP update, MWD staff has stated that such review is not required because the IRP is not a document that controls future decision-making in a manner that could result in the possibility of a significant effect on the environment. However, MWD staff has also stated that it intends to take immediate action to implement projects and programs identified in the draft IRP should it be adopted by the Board. When viewed in its entirety, the discussion of the IRP and the Preferred Resource Mix suggest the IRP is viewed by MWD as a controlling document that would be the first step in the implementation of a major new supply program and would be subject to CEQA. If this is not the case, MWD must make that clear and should also provide assurance that CEQA compliance will be accomplished before any actions are taken to implement any of the programs or projects contemplated as part of the draft IRP's Supply Buffer.

Seawater Desalination Project Subsidies

On page A-4 and again on page A-31, under *Seawater Desalination*, MWD mischaracterizes the Carlsbad seawater desalination project and the status of the incentive payment agreement with MWD relating to this project. MWD also fails to disclose the fact that MWD has initiated termination proceedings on incentive payment agreements with the Water Authority and its member agencies, and, that it is MWD that has refused to sign the Carlsbad Seawater Desalination Project agreement approved by its own board on November 10, 2009.

In the Seawater Desalination Sections of Appendix A on Pages A-4 and A-31, Metropolitan addresses the status of member agency agreements for incentive funding for seawater desalination projects, including the Water Authority's incentive funding agreement. Metropolitan states that "SDCWA has not executed the proposed agreement." This statement would mislead the reader to conclude that but for SDCWA's execution, the agreement would be in effect today. That is not true. The Water Authority's incentive funding agreement, approved by the Metropolitan Board on November 10, 2009 and by the Water Authority Board on December 17, 2009, includes rate structure integrity language that allows Metropolitan to terminate the agreement should the Water Authority file litigation to challenge Metropolitan's rate structure. Following the Water Authority's initiation of litigation in June 2010 (briefly discussed on page A-47) challenging Metropolitan's rates and charges, Metropolitan's Board initiated termination of existing Water Authority funding agreements that include rate structure integrity language. On August 25, 2010, in a letter to the Water Authority from Metropolitan's General Manager (attached), the Water Authority was notified that "Metropolitan's Board of Directors also directed staff to defer execution" of the Water Authority's seawater desalination incentive funding agreement "…as termination proceedings would begin

immediately upon execution." These facts regarding the Carlsbad Seawater Desalination Project agreement should be stated on pages A-4 and A-31.

Near-Term Delta Actions
On page A-25, under *Near-Term Delta Actions*, MWD discusses the potential supply benefit of the proposed Two-Gate System and other "near-term" actions to improve water supply and ecosystem of the Delta. However, MWD does not provide a timeline estimate of when it expects the Two-Gate project to be in place and producing improved supply reliability of approximately 150,000 acre-feet per year in certain years. We request an estimated operational date for the Two-Gate project be added to this discussion.

Five-Year Supply Plan
On page A-26, under *Local Resources*, MWD projects that 122,000 of additional, new supply could be online by 2014 from recycled water treatment plants, groundwater recovery plants, desalination plants and new hookups to existing recycled water plants. This figure seems optimistic based on the experience. If MWD indeed projects this level of implementation, it is not our belief that the costs associated with such level of local resources development have been included in the budget or water rates adopted for 2011 or 2012. We request that the estimated costs and associated water rate increases be added to this discussion. In addition, given the long lead time generally associated with the development of such projects, we believe MWD should describe the process by which it will be able to implement local projects of this magnitude within the timeline described in the O.S.

Significant Exposure to Reduced Sales
On page A-29, Appendix A describes a construction project that will provide an interconnection between the Antelope Valley-East Kern Water Agency and the Los Angeles Aqueduct. Under an agreement with MWD, the City of Los Angeles will be able to acquire and move into the LA Aqueduct supplies obtained independently of MWD. This section notes that the annual quantity of supplies moving into the LA Aqueduct through the interconnection is "…not to exceed the supplies lost to the City as a result of its Eastern Sierra environmental obligations, including water for the Lower Owens River Project and Owens Lake Dust Mitigation Project…." That amount, Appendix A notes, was 98,000 acre-feet from April 2009 to March 2010. However, MWD does not disclose that the City of Los Angeles currently purchases water used to offset the use of its own Eastern Sierra supplies for environmental purposes from MWD, and that the interconnection with AVEK will allow LA to reduce its purchase from MWD on an acre-foot-for-acre-foot basis. Reduction of sales by approximately 100,000 acre-feet per year will have a material effect on MWD revenues and on MWD's water rates. And yet, on page A-30, MWD asserts that the City of LA's "future reliance on Metropolitan supplies may increase with implementation of these (Eastern Sierra environmental) projects." The motivation for LA to pursue the interconnection with AVEK in the first place is its apparent belief that it can acquire independent supplies at a lower cost than MWD's supply cost. Therefore, in contrast to the statement on page A-30, it is more likely LADWP will acquire any additional environmental offset water needed from sources other than MWD.

Future Water Sales and Receipts
On Page A-69, and again at A-71 to A-72, MWD projects steady growth in water sales over the next five years from 1.77 million acre-feet in the current fiscal year (2011), to 2.11 million acre-feet in FY 2015, "…reflecting a return to average weather conditions." This projection appears to attribute the current low water demands on MWD (and reduced sales) to a single factor: weather. A return to

normal weather, the report implies, will result in returning sales to pre-shortage levels. No discussion or consideration is provided to what effect other factors –most notably higher water rates – have had, and continue to have in suppressing water demand and sales. The O.S. also fails to discuss or take into account the recently passed 20x2020 legislation requiring 20% conservation at the retail level. Appendix A should provide an analysis of the impacts higher water rates and conservation requirements are having on demand and sales, and factor those impacts into projections of future water sales (e.g. the next five fiscal years and beyond).

Page A-72 notes that because of lower-than-budgeted water sales in the current year (160,000 acre-feet lower than budgeted), MWD will make a draw of $34 million from its Water Rate Stabilization Fund. However, on September 17, 2010, at the MWD Member Agency Managers meeting, MWD management reported that the net draw from the Water Rate Stabilization Fund this year is projected to be $100 million. MWD should reconcile these two figures and ensure the number reflected Appendix A is the correct one.

We believe the comments contained in this letter and the attachments must be addressed through substantive modifications to Appendix A and request those changes be made to ensure MWD provide accurate and adequate disclosure to potential investors.

Thank you.

Sincerely,

Lynne L. Heidel

Lynne Heidel
Director

Keith Lewinger

Keith Lewinger
Director

Bud Pocklington

Bud Pocklington
Director

Fern Steiner

Fern Steiner
Director

Attachments

Cc: MWD Board of Directors
Jeff Kightlinger, General Manager

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

September 10, 2010

Jeffrey Kightlinger
General Manager
Metropolitan Water District of Southern California
PO Box 54153
Los Angeles, CA 90054-0153

Re: 2010 Integrated Resources Plan Update

Dear Jeff:

Water Authority staff has completed its review of the draft 2010 Integrated Resources Plan Update (draft IRP). We plan a broader outreach effort to our region's cities, stakeholders and communities once we have complete information and a revised draft IRP document. Given that the current draft IRP has only been available since July, and since the revised draft won't be available until sometime later in September, we reiterate our request that the October timeline for adoption of the IRP be extended to allow for broader distribution of the revised draft IRP here and in other parts of the MWD service territory. This outreach should then be followed by additional public meetings of MWD's board so that the merits of the revised draft IRP can be fully deliberated in a transparent setting after MWD responds to all the current comments and questions.

Changed Circumstances

The water supply and cost environment have fundamentally changed since the IRP was last updated in 2004. Twenty percent water conservation is now legally required at the retail level by 2020. Replenishment deliveries by MWD have been interrupted indefinitely. Severe cutbacks of water supplies from the Bay-Delta are now a way of life for the foreseeable future. We must plan for impacts of climate change. As a result of these and other changed circumstances – and taking into account the reasonably anticipated cost of a Delta Fix – conservation and local projects that once warranted subsidies have become cost effective compared to MWD's current and projected water rates. For this reason, many of the more than 250 retail water agencies and cities in the MWD service territory are now in the process of expanding conservation programs and developing local water supply projects.

Although the draft IRP refers generally to some of these changed circumstances, it does not recommend any changes in the basic MWD business model to address them. The draft IRP plan essentially assumes the same base resource mix and adds a massive, undefined "Buffer Supply" to mitigate undefined and unquantified uncertainties. Instead of asking how it may best *coordinate, encourage and integrate* with planned conservation and local water supply development that is already under way throughout the service territory, MWD proposes to embark on a massive spending program.

Stranded Costs and Stranded Historic Imported and Low Cost Water

MWD's IRP strategy will drive MWD's rates up drastically and lead to lower water sales by MWD as local agencies develop lower-cost supply alternatives. With the Buffer Supply strategy in the draft IRP, MWD is setting itself up for a perfect storm of skyrocketing water rates and plummeting water sales. This course of action amounts to a fiscal death-spiral for MWD and is financially unsustainable.

While it is not possible to determine from the draft IRP precisely what the current core supplies are or how the proposed Buffer Supply will be developed as MWD projects and member agency projects (or any iteration thereof), one thing is very clear from the draft IRP: *MWD is embarking on a course of action that will result in abandonment of MWD's historic investments in water supply infrastructure and low-cost core water supplies in favor of far more expensive water.* A graph illustrating this practical effect of the IRP is included as Attachment 1 to this letter. That graph shows that MWD's Buffer Supply strategy will lead to 500,000 acre-feet of imported water being stranded by MWD each year, in favor of more expensive local supplies developed by MWD at a cost of more than $1 billion annually on MWD's rates (2035). <u>It is imperative that MWD take the time now to refine this draft IRP to avoid creating stranded water and the associated stranded costs we will be asking our ratepayers to cover for decades to come.</u>

Detailed Comments on July Draft IRP

Our detailed comments are included in Attachment 2 to this letter in the following broad subject matter categories:

- *Water Rate Impacts*
- *Conservation*
- *Commitment to the Delta*
- *Stranded Costs*
- *Why Abandon Historic Investments and Low Cost Water?*
- *Respect for Local Autonomy*
- *Definition of Region*
- *Outdated Reliability Goal*
- *Need to Integrate Member Agency and Local Planning Data*
- *Failure to Identify Key Issues to Maximize Surface Storage, Groundwater Storage and Conjunctive Use*
- *The Problem with Water Insurance, aka "Buffer Supply"*
- *"Adaptive Management" Inadequately Defined*
- *Inaccurate and Incomplete Data*
- *Process Concerns*
- *Recommendations*

We met with our member agency managers to obtain their perspectives, comments and questions. The August 10 IRP forum in San Diego was well attended by our agency managers and many questions and comments were presented to you directly at that time. A list of those questions is included as Attachment 3 to this letter.

We request that MWD staff distribute a revised draft IRP once it has an opportunity to respond to comments and questions raised here and at the IRP Stakeholder Forums, and to review and reconcile the data in the report so that it is both internally consistent and consistent with MWD's Regional Urban Water Management Plan.

Please let us know what the timeline is for receiving your written responses to this letter and the questions asked at the IRP Stakeholder Forums. We hope to work with you to complete an IRP that will provide a solid roadmap for the future for all of Southern California.

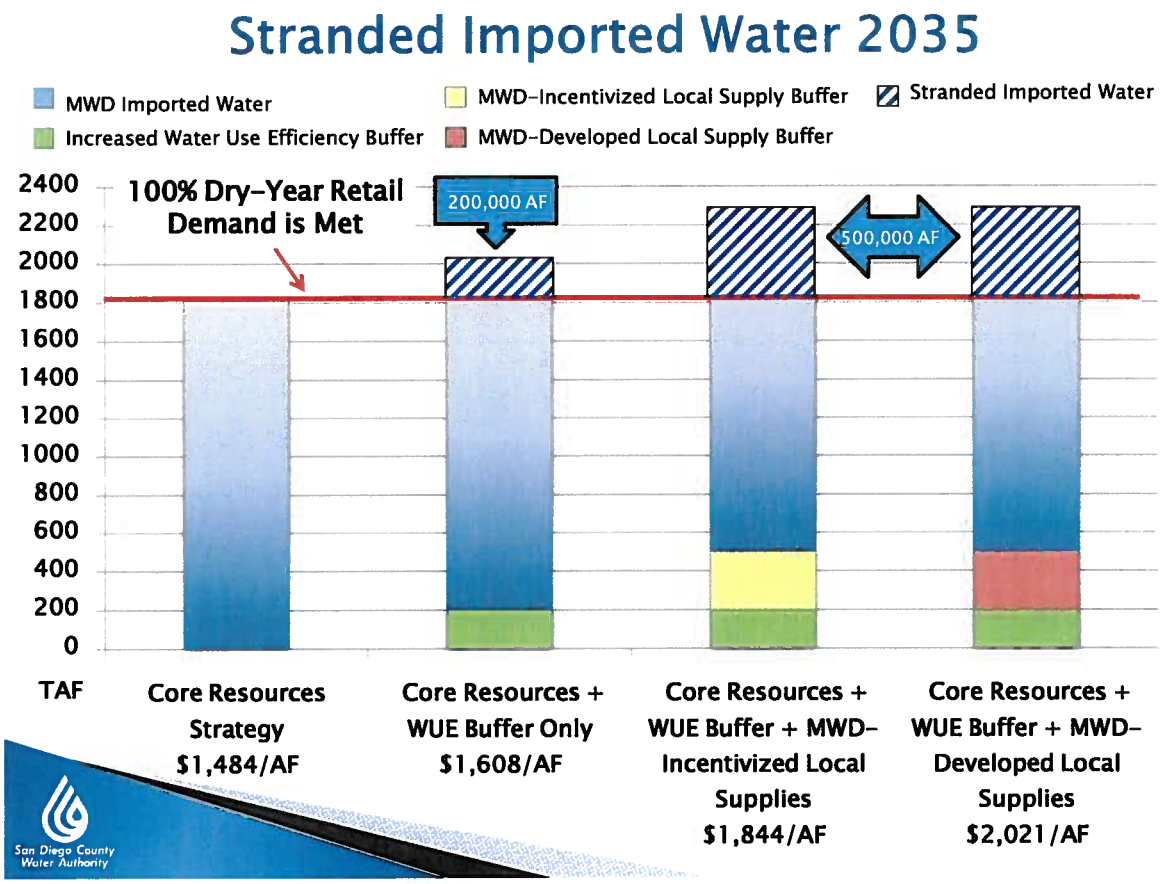
Sincerely,

Maureen A. Stapleton
General Manager

Attachment 1: Stranded Imported Water in 2035
Attachment 2: Comments on MWD's July Draft 2010 IRP Update
Attachment 3: Questions posted at San Diego IRP Forum

cc: MWD Board of Directors
MWD Member Agency Managers
Water Authority Board of Directors
Water Authority Member Agency Managers

ATTACHMENT 1– STRANDED IMPORTED WATER IN 2035



ATTACHMENT 2 – COMMENTS ON MWD'S JULY DRAFT 2010 IRP UPDATE

WATER RATE IMPACTS

With the unprecedented recommendation to develop 25% more water than MWD demands require, the draft IRP is extremely light on its analysis of potential rate impacts. The only rate analysis included in the draft was a table in Section 3 prepared for the board's strategic policy discussion and not related to the recommendation to implement the Buffer Supply. Presumably, the supplies being developed under the Core Resources Strategy would generally be lower in cost than those under Buffer and Foundational Actions. The implementation of the Buffer Supply will require substantial financial investment by MWD and its member agencies. A critical analysis of potential rate impacts and the impact rate increases will have on demand must be completed and deliberated by the board before it takes a policy direction on the IRP and implementation of a Buffer Supply.

In mid-August, MWD's staff presented a "2010 IRP Average Rate Analysis" on four implementation strategies for the IRP. The presentation showed the difference in the rate increase between the Core Resources Strategy – one that MWD admits meets all projected dry-year demand – and the plan's recommended strategy to develop 500,000 acre-feet of additional Buffer Supplies is only 2 percent, a deceptively and alluringly low number that obscures the actual difference in cost ratepayers would experience between implementing the Core Resources Strategy and any one of the three Buffer Supply strategies. The difference amounts to up to $537 per acre-foot in 2035 – a 36% difference in water rates in that year; this is not insignificant.

More troublesome, however, are some of the assumptions that went into the rate analysis. MWD currently funds about $20 million for its water conservation programs, which it projects would result in about 10,000 acre-feet of new conservation annually. Both the 20x2020 retail mandate and 20x2020 regional consistency require investment far beyond the current conservation effort. Under the 20x2020 regional consistency analysis, staff estimated 580,000 acre-feet of water use efficiency beyond that anticipated through current conservation programs is needed. Yet, only $20 million is assumed in the analysis to achieve the conservation goal that is significantly higher than what the current investment is producing. Similarly, the rate impact for Buffer implementation assumes MWD continues the $250 acre-foot subsidy for local projects development at the same time it is proposing investments in local water supply development that greatly exceed this cost. Another example: in the MWD-Developed Buffer Supply scenario wherein MWD assumes financial responsibility for 500,000 acre-feet of conservation and local supply development, MWD's operations would surely grow, yet the rate analysis shows zero cost difference in the Departmental O&M from the Core Resources Strategy; this appears to be an unrealistic assumption. Another example: zero cost has been assigned to account for the project development costs and risks associated with the Foundational Actions component of the plan.

MWD's failure to calculate or acknowledge the true cost of water by basing the rate impact analysis on unrealistic assumptions does a disservice to Southern California ratepayers and only pushes the hard decisions to another day. We request that a more realistic set of cost assumptions be used to conduct the rate analyses associated with the IRP and that this information be available for full discussion and deliberation by MWD's board of directors.

CONSERVATION

The Water Conservation Act of 2009 (the Conservation Act, or 20x2020) established new methodologies, water use targets and reporting requirements. The Act's requirements apply to urban *retail water suppliers*. Although MWD and its wholesale member agencies have a supporting role, primary responsibility for compliance with the law falls to each retail agency within MWD's service territory. The draft IRP does not address these requirements or explain how a regional program would integrate with, or support these retail conservation programs.

MWD's recent board memo on water conservation concluded that accounting for conservation at the individual member agency level would be too difficult and would threaten the efficacy of MWD's Integrated Resources Plan, Water Supply Allocation Plan and other programs. We respectfully disagree, and point out that local agencies already do so as part of their Urban Water Management Plans (and other plans). It is imperative that the MWD board consider changed circumstances and legal requirements to ensure that any future regional conservation program integrates with local programs, and avoids creating conservation disincentives through the pricing structure, water supply allocation plan, or otherwise.

While the draft IRP appears to *assume* a regional compliance approach, the Conservation Act provides that urban retail water suppliers must achieve and report compliance on an individual basis unless certain prerequisites for regional compliance and reporting are met. Among other things, regional compliance requires the written consent of each retail agency. MWD should factor this legal requirement into its analysis in the revised draft IRP.

Indeed, as a wholesale water provider, MWD's role in conservation must be carefully evaluated in light of these new legal requirements. Since it is unlikely that all retail water suppliers within MWD's service territory will elect to report as part of MWD's regional water management group, MWD must account for that as the regional program is being developed. MWD must carefully assess how a regional program can fairly integrate with the individual programs its member agencies, and their respective retail agencies, choose to implement to ensure that each retail agency and group of ratepayers is carrying its legally required, fair share of the cost.

Changes will also be necessary to MWD's water shortage allocation plan in order to encourage conservation. The City of Long Beach has presented a number of ideas and approaches to address this concern that should be thoroughly evaluated and considered. We also believe that MWD's wholesale price structure discourages conservation by disguising the true cost of alternative water supplies. By continuing to offer regional subsidies to retail agencies to meet water use efficiency targets that are legally required of them, MWD is actually discouraging water conservation – unless, that is, MWD pays for it. Any regional program must <u>start where the legal requirement on the retailers *ends*</u>, otherwise, MWD is simply robbing Peter to pay Paul and rewarding free riders. And, by subsidizing compliance with the retail 20x2020 targets, funds that MWD collects from some of its member agencies will be benefitting (subsidizing) compliance of other member agencies while providing no commensurate benefit to the "donor" agencies, because those donor agencies do not receive "credit" toward their own 20x2020 compliance goals for spending money (via the MWD subsidies) in other retailers' service areas.

These donor agencies must additionally spend their own rate money to meet their own compliance requirement.

As noted earlier, we believe that measurement and verification are essential to any water use efficiency program, and is in fact, required for compliance. We would note that the data MWD uses to support the conservation section of the IRP is, except for the current demographic data from SCAG and SANDAG, outdated (Attachment A.1, Attachment C-2) (1997). One of the recommendations in the 1997 report was that MWD expand the coverage of its conservation data base to include the many MWD member agencies with respect to which conservation data was not available. (See IRP Attachment A-1 at Attachment C-40)

We believe there is an important role for MWD in water conservation but that its programs must change in order to address the concerns described above. The draft IRP fails to address these important considerations.

COMMITMENT TO THE DELTA

Many agencies and stakeholders are reading the draft IRP recommendation to "immediately" and "aggressively" implement 500,000 acre-feet of Buffer Supply as a signal that MWD is abandoning, or does not believe that it will be successful in fixing the Delta. This comes as a big surprise to our community, which worked tirelessly on the 2009 water bill package and water bond. We do not support changing course and believe that we must diligently pursue and protect our investment in the Delta and State Water Project. The Delta Community is also counting on our continued support. It is our understanding from the information provided by MWD that the Core Resources Strategy includes both a Delta Fix and continuation of existing Colorado River programs contemplated by the Quantification Settlement Agreement. We believe this is the correct approach and consistent with MWD's core mission.

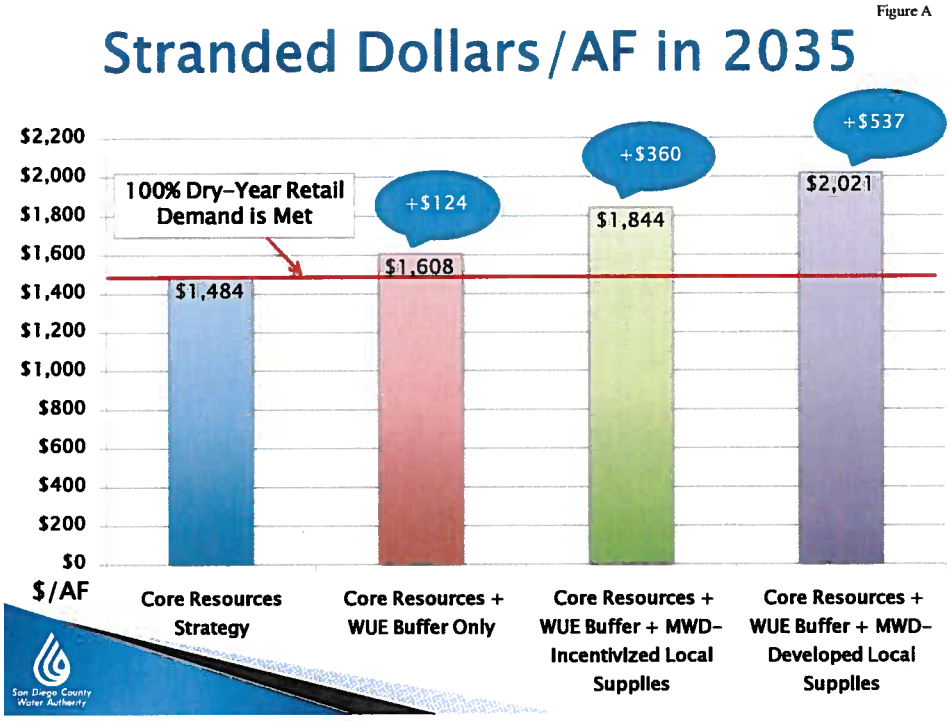
This having been stated, the Water Authority is open to having a candid discussion with MWD, the Delta Community and all interested parties about the nature and extent of the Delta "Fix," if MWD has grown skeptical of the prospects for success in the Delta. In the meantime, and unless and until a *conscious decision* is made – with the benefit of analysis and input from all affected parties – we believe the call for a Buffer Supply sends the wrong message vis-à-vis MWD's intentions in the Delta – and an expensive message at that.

STRANDED COSTS

Since the drought in the early 1990's, MWD's water management strategy has been to invest in storage to take advantage of the hydrologic cycles to best utilize low-cost, available water. Today, this investment, which stands in excess of 5 million acre-feet of storage capacity, has served the region well during the current supply challenges. But, rather than continuing this management strategy to optimize the historic investment in the State's water supply infrastructure and MWD's own low-cost imported water, the draft IRP proposes to shift course in favor of MWD developing local water supplies at a high cost to its ratepayers.

The development of the Buffer Supplies would lead to a similar outcome. If these supplies are not needed – and the draft indicates that demands for the Buffer Supplies will not exist – then the costs to develop them are truly in excess of need and stranded and, therefore, will be stranded costs. A graphic illustration of the stranded costs is shown below in Figure A.

Figure A



It is important that MWD integrate its planning with those of its member agencies so that it does not find itself with stranded investments and future unexpected rate increases due to poor planning.

WHY ABANDON HISTORIC INVESTMENTS AND LOW COST WATER?

Staff's rate analysis released in mid-August sheds light on the following facts: the immediate implementation of Buffer Supply, whether limited to regional consistency Water Use Efficiency of 200,000 acre-feet or the entire 500,000 acre-feet inclusive of local projects would result in abandonment of like amounts of lower-cost imported water, even after it has obligated its share of the Delta Fix improvements. Case in point, in 2035, with Buffer Supply inclusive of Water Use Efficiency only, MWD's own rate analysis showed it would forgo a like amount of imported water due to reduction in sales. The situation worsens if MWD implements the entire 500,000 acre-feet of Buffer Supply, under both MWD-Incentivized and MWD-Developed Buffer Supply scenarios, 500,000 acre-feet of imported water is forgone. Why would MWD spend billions of dollars to develop new supplies and, at the same time, plan to forego use of those supplies?

RESPECT FOR LOCAL AUTONOMY

The key question addressed in the draft IRP focuses on the "role" of MWD. But, with due respect, we believe it's the wrong question. The focus should not be on MWD's "role," but on how the most reliable, cost-effective water supply can be provided to water ratepayers, being

mindful that not every retail water supplier or even every "region" within the vast MWD service territory will answer that question the same way. MWD's "top-down, all-in" planning model in which it will assume responsibility over local water supply development fails to take into account the many cities, local agencies and groundwater managers who grapple with local water supply development issues every day. It is an open question what role these agencies and water suppliers would like MWD to play, but it is certainly important to ask. Historically, the answer to that question would be easy: they want funding to help support local water supply development. We believe that there *is* a role MWD can play in helping to support local projects including funding mechanisms for local supply development. But the rules must be firm and fair, laid out in advance, and equitable to all parties.

DEFINITION OF REGION

Given the dramatic shift in the draft IRP from imported water supplier to local supply developer, MWD should take a step back and ask itself, its member agencies and, critically – the hundreds of cities, counties, water suppliers, groundwater managers and other local districts – how they define their "region" for purposes of local water supply development. MWD has been Southern California's principal "regional" *imported* water supplier. That does not mean that it will be efficient or even logical for MWD to become Southern California's "regional" *local* water supplier. The State, for example, recognizes nine separate IRWM planning groups that are wholly or partially within the MWD service territory. What makes sense for "regional" local water supply development needs to be discussed between and among all interested parties, not just MWD and its member agencies, and be defined in a manner that is practical, workable and equitable to all parties. It is likely that not all local and regional agencies desire to be under the planning umbrella of MWD and its member agencies – whose member agencies often have goals, priorities and objectives that are different than their own.

OUTDATED RELIABILITY GOAL

By declaring allegiance to the 1952 Laguna Declaration, the draft IRP misses a critical opportunity to signal that it is no longer "business as usual" in Southern California or at MWD. Indeed, where and how to establish the reliability goal was not even discussed as part of the IRP process. In today's water-scarce, high-rate environment, our customers want a choice about the level of "regional" reliability they want to pay for.

But the draft IRP goes even further, it advocates a reliability goal of developing core supplies to meet full-service dry year demands at the retail level under all foreseeable hydrologic conditions, *plus* developing a Buffer Supply of 10% of retail demand, *plus* completing project planning for an array of additional projects based on undefined "uncertainty" (the Foundational Actions). This "Laguna Declaration-*Plus*" approach is excessive, impractical and fiscally imprudent. It also flies in the face of California's changed circumstances and Southern California's conservation ethic.

Before staff recommends the highly aggressive supply development outlined in the draft IRP, it should communicate with each of its member agencies to determine the extent to which those

agencies intend to rely upon MWD to meet their future supplemental water supply needs. As aptly noted in the 1994 Blue Ribbon Task Force Report,

> "[It was troubling] to learn, for example, that some of the member agencies most strongly supporting big-ticket projects...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 customers." -- BRTF Report at page 23.

Just as in the past, it is clear that some of the MWD member agencies most strongly supporting the draft IRP are doing so precisely because they believe that it will allow them to become <u>less dependent upon MWD</u>.

NEED TO INTEGRATE MEMBER AGENCY AND LOCAL PLANNING DATA

The draft IRP identifies the need for only 16,000 acre-feet of local projects to achieve the Core Resources Strategy target in 2015 and only 46,000 acre-feet by 2025 and through the end of the planning horizon (2035). According to the draft IRP, this will result in 100% supply reliability under all hydrologic conditions to meet dry-year demand. It is important to note that in reaching the 100% reliability assessment, the plan has taken into account regulatory and environmental constraints on supplies from the Bay-Delta in the years before mid- and long-term Delta improvements are completed.

Based upon review of the limited data included in Appendix A.5 of draft IRP, it appears that as much as 750,000 acre-feet of local water supply is already being planned by MWD member agencies. It is unclear whether this list includes all supply projects that are being planned by cities, groundwater managers, replenishment districts, utilities and other agencies and water suppliers throughout Southern California. Given that the draft identifies only 46,000 acre-feet of local projects is needed to achieve Core Resources strategy's 100% reliability goal, the draft IRP fails to grapple with the reality that MWD sales will be <u>reduced, not increased</u> in the future. If properly coordinated, this trend can be a positive outcome for MWD and all of Southern California. But MWD threatens to disrupt the positive economic impacts of this shift by proposing to over-invest in new water supplies in an ill-fated and illusory attempt to increase its own sales. Failure to coordinate with the many cities, water districts, and utilities beyond MWD member agencies places all Southern California water ratepayers at risk.

The draft IRP also does not provide projected supplies under average- and wet-year hydrologic conditions and their frequencies of occurrence. The draft shows only how MWD's storage would fare under "average" conditions. Figures 4-5 and 4-6 reflect very healthy storage conditions for MWD, but lack data for member agencies to assess how their surface reservoir or groundwater basins could be augmented for dry year use.

In summary, although the IRP by definition is intended to be an *integrated* plan that takes member agency and retail supply plans into account as part of MWD's regional planning, the

IRP draft fails to do so. This presents grave risk to MWD and Southern California water ratepayers.

Finally, MWD's historic and principal role has been to deliver water to Southern California imported from the Colorado River and State Water Project. The subsidy programs were originally created to "encourage" conservation and development of local water supplies that were otherwise not cost-effective, and, in order to "send the right message" to Northern California where it was seeking to maintain its State Water Project entitlement. The rationale was that by supporting these local water supply investments, the costs of securing additional imported water supplies and/or infrastructure were "avoided," and thus the payment of MWD subsidies benefited the region as a whole. MWD should take the time now as part of the IRP planning process to consider the appropriate role of subsidies generally, and including whether subsidies are encouraging or impeding desired outcomes.

FAILURE TO IDENTIFY KEY ISSUES TO MAXIMIZE SURFACE STORAGE, GROUNDWATER STORAGE AND CONJUNCTIVE USE

The draft IRP says that Metropolitan has "gradually shifted from being exclusively a supplier of imported water to collaborating with its member agencies on regional water supply planning issues." This statement does not capture the momentous change that is being recommended for adoption in the draft 2010 IRP, which will place MWD in control of planning, outreach, all state and federal funding and decision-making about local project development. While the draft promises that MWD will "collaborate" with agencies outside of their own member agencies, it appears that it has not collaborated with them in proposing this new role for MWD in the first place. Willingness to allow MWD to become the regional master facilities planner may also vary by region.

MWD's principal, historic role has been as a supplemental, imported wholesale water supplier to its member agencies. While "collaboration" with its member agencies is indeed important, MWD is announcing in the draft IRP a substantially different and enhanced role for itself in the future, including "master planning" for significant local water supply resources over which it has no legal jurisdiction or expertise. The draft IRP does not so much represent a "gradual shift" as a takeover strategy for local water supply development in which MWD will be in charge of local water supply development through its regional master planning process. For example, MWD is declaring that it will be in charge of "master planning" for the following activities:

1. Recycled water development, including creation of a regional finance committee that will determine how all state and federal funding dollars are best spent (Table 5-5);
2. Preparation of salt management plans and groundwater basin management plans (Table 5-7);
3. Seawater desalination "integration" (Table 5-10) and funding mechanisms (Table 5-13); and,
4. Stormwater capture, including regional master planning, implementation of pilot projects and development of subsidy programs (Table 5-19).

MWD's newly announced role as "master planner" for all Southern California local water supply development goes far beyond the function of "collaboration" described above. Given that it has little expertise in groundwater and developing local projects, staffing and budget increases will undoubtedly be on the horizon. These efforts will duplicate those of the many local water suppliers, replenishment districts and groundwater managers who are already engaged at the local level.

In lieu of these proposed changes, MWD should follow the same, more cautious guidelines it suggests for graywater (see page 5-36), namely,

1. Do not establish subsidies to pay for graywater;
2. Focus instead on reviewing and suggesting standards and pursuing changes to legislation and regulations to support graywater development;
3. Work with local entities to create model guidelines for permitting processes; and,
4. Assist with public information efforts as requested and appropriate.

Finally, the draft IRP fails to address the most fundamental questions that must be addressed by MWD at the wholesale level, including: 1) how available imported water supplies will be managed; and 2) what policies are needed to assure fair access to facilities in order to move water stored in groundwater basins in and out of, and within the MWD distribution system.

THE PROBLEM WITH WATER INSURANCE, AKA "BUFFER SUPPLY"

The draft IRP recommends implementation of the Buffer Supply as an insurance policy against uncertainties, but does not provide a quantitative analysis or risk assessment to show how the 500,000 acre-feet of supply development was derived. For this reason, the Buffer Supply is purely speculative.

The Buffer Supply is also financially unsustainable under the current rate structure, since agencies would only pay for the "insurance" when they file a "claim" for the water. The cost of maintaining a large "standby" supply will be extraordinarily expensive, force MWD rates to increase exponentially, and, drive water purchasers away from MWD in search of lower cost supplies that they can control. Here again, the 1994 Blue Ribbon Task Force had it right:

> "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." -- BRTF Report at page 9.

While the draft IRP itself is silent on the cost of the Buffer Supply, MWD's mid-August rate analysis showed startling costs of the Buffer Supply, in terms of sky-high water rates, stranded water supply and stranded costs. The two charts included with these comments were developed based upon this mid-August rate analysis.

Furthermore, the draft IRP appears to ignore the fact that MWD already has a substantial "Buffer" in which it has invested, namely, MWD's vast storage program. MWD has 5 million acre-feet of storage, which the draft IRP indicates will be full on average. The draft IRP also says that if the Core Resources Programs are implemented, the region could have an excess of 1 million acre-feet of water during dry years, when storage and transfers are factored in. If the 500,000 acre-feet Buffer Supply is implemented, *without* MWD taking any water from its storage, the region will have more water than required to meet demands including filling all available storage. The bottom line is that the draft IRP fails to factor in that the very purpose of the existing storage is to provide the same dry year assurance that is proposed to be filled by the new Buffer Supply.

"ADAPTIVE MANAGEMENT" INADEQUATELY DEFINED

Although the draft IRP says that MWD will employ an "adaptive management" strategy, the draft also concludes that an aggressive approach to immediately implement the Buffer Supply is required. In general, it is not possible to discern from the draft IRP what the timing or "triggers" are for any of the "adaptive" actions. The draft IRP is also inconsistent with statements made by MWD staff at the August 10 San Diego Stakeholders Forum with regard to timing of adaptive management actions described in the draft IRP.

At its own August 20 member agency managers' meeting, MWD staff stated that it plans to only recommend immediate implementation of the regional consistency Water Use Efficiency Buffer, and leave the implementation of the Local Resources Buffer to occur only when certain trigger events take place, such as failure to obtain the environmental documentation for a Delta conveyance facility by a date-certain (yet to be specified). This is a very different position than the draft's aggressive approach to implement local projects as delineated within the draft IRP as follows:

> Page 4-20, "Implementing a Supply Buffer," states, in part: "...a 'planning' Buffer was introduced during the 2004 Update. The 2010 IRP Update proposes to expand the concept of a planning Buffer and <u>create an actual hedge</u> against demand uncertainty, by <u>implementing</u> a supply Buffer equivalent to 10 percent of total retail demand. Metropolitan will collaborate with the member agencies to <u>implement</u> this Buffer through complying with the 20X2020 legislation, and by <u>implementing aggressive</u> adaptive actions to meet any remaining portion of the 10 percent Buffer." (Emphasis added.)
>
> On page ES-8, the draft states: "Maximizing regional benefits through economies of scale and minimizing the cost of redundancy is important to adaptability. The 2010 IRP Update <u>will</u> hedge against demand, supply and environmental uncertainties by <u>implementing</u> a supply Buffer equivalent to 10 percent of total retail demand. This Buffer <u>will be implemented</u> through meeting 20X2020 water use efficiency goals, and by <u>implementing aggressive adaptive actions</u> to meet the remaining portion of the 10 percent Buffer through local supplies and transfers. This approach is consistent with maintaining reliable baseline supplies and advancing local and regional solutions." (Emphasis added.)

> In its outreach materials used at the IRP Public Forums, MWD has an executive summary, page ES-10, that states the Buffer Supply will be "...developed through collaboration with the member agencies on aggressive actions." And, on Figure ES-4, Component 2 box reads "aggressive adaptive actions for the remainder." (Emphasis added.)

It is impossible to reconcile the oral comments made by MWD staff at the August 10 Stakeholder Forum and the August 20 MWD Member Agency Managers meeting with the conflicting verbiage in the draft IRP document.

It is also completely unclear what "adaptive management" means or how it will be employed by the MWD staff once the IRP is adopted by the board. Substantially more detailed planning and transparency is required before board adoption so that the member agencies can better understand what is intended by the draft IRP.

INACCURATE AND INCOMPLETE DATA

The Core Resources Strategy is the heart of MWD's current water supply planning. It is essential that the draft IRP provide a full description of the components of the Core Resources Strategy. And yet, it is not possible to discern the details of the Core Resources Strategy due to the fact that there is inconsistent data presented throughout Sections 4 and 6 of the draft IRP. These are the key sections of the report that present analyses of the available water supplies and need to develop additional supplies.

To ensure a sustainable resource plan that clearly outlines a path for long-term reliability, it is fundamental that the draft IRP start with a more comprehensive evaluation of the Core Resource Strategy. The Core Resource Strategy serves as the foundation of the plan. The analysis should include an identification of what actions can be taken to strengthen the core strategy in order to maximize investments already made in imported supplies. The evaluation should include an assessment that clearly identifies the risks associated with implementation of the core strategy and takes adaptive measures to mitigate those risks. This assessment would provide a linkage between the Core Resource Strategy and the timing and type of adaptive management strategies recommended. Transparency in the process is critical to providing the member agencies the data and information needed to plan accordingly in their UWMP and resource plans.

In addition to the internal inconsistencies, the data included in the draft IRP is also inconsistent with data included in MWD's recently released draft Regional Urban Water Management Plan (RUWMP). The Water Authority suggests that MWD staff conduct a workshop with the member agency managers to work through this detail so that MWD's Core Resources Strategy can be presented in a manner that may be better understood and inconsistencies with MWD's RUWMP can be reconciled.

To cite just a few examples, seawater desalination is listed as existing production on Table 4-6 but as a yet-to-be-developed Core Resource on Table 4-8. There is no indication how the groundwater, local surface water and Los Angeles Aqueduct (LAA) supplies listed in Table 4-7 were projected. And, it is unclear why there is an increase in groundwater supplies during this

planning horizon, but a decrease in surface water. The data for LAA also differs between the IRP and RUWMP. These and other inconsistencies and lack of foundational data are not "details" to be "worked out later" – rather, this is foundational information required in order to meaningfully assess MWD's current supplies and the need to develop additional supplies.

Beyond the internal inconsistencies in the draft IRP, there is also insufficient information provided on the plans of cities, groundwater agencies, replenishment districts, utilities and water suppliers throughout the Southland to implement conservation and other local water supply programs that will substantially reduce the amount of water purchases from MWD in the future. While the draft notes that there are approximately 250 retail agencies that supply water to the public, the draft IRP analysis has failed to account for the plans and timing of plans that many of these 250 retail agencies have to both conserve water and develop local resources. Although Appendix A.5 includes a list of member agency area projects, it does not provide analysis to show how these projects will reduce the demand for MWD supplies. It also does unclear whether it includes projects of the many agencies, sub-agencies and utilities who presently buy water from MWD member agencies. MWD must work with its member agencies to develop an accurate and agreed upon list of projects as well as project timing, and eliminate inconsistencies before it finalizes the draft IRP.

Moreover, MWD's methodology limits its accounting of local supplies to existing, under construction and "committed" projects (a term not defined in the draft IRP). All other planned local projects are included as part of MWD's own "regional" target, with the explanation that, "... [t]his recognizes the uncertainty in local supplies and avoids over and under allocating local supply targets to individual agencies" (see Appendix A.1-22, "Projected Active Conservation: A New Approach). This approach appears grounded in MWD's past experience and the notion that local water suppliers cannot be relied upon to develop local supplies and, therefore, MWD must step in and take over responsibility for local supply development. This assumption fails to take into account the substantially changed circumstances and that many local water supply projects that were once uncompetitive with the price of imported water are now cost-effective – without any subsidies from MWD – when compared to even the conservatively projected cost of MWD water. There are also better mechanisms to hold local water suppliers accountable to the region for completion of projects than the theoretical no-cost or low-cost water supply Buffer "insurance" recommended in the draft IRP.

The realistic regional demand "gap" cannot reasonably be estimated without taking into account the existing and planned actions of MWD's member agencies and other local water suppliers. The draft IRP notes that Metropolitan has historically provided between 45 and 60 percent of the municipal, industrial, and agricultural water used within its service area. However, enhanced conservation and development of local water supplies will result in a dramatic reduction in water demand on MWD. Implementing any of the Buffer Supply strategies in the draft IRP will lead to unavoidably higher rates and inversely declining sales.

PROCESS CONCERNS

While there have been a large number of meetings and IRP-related "processes," the process overall has been both "top down" and "disintegrated," with no meaningful opportunity for non-MWD member agency participants to shape the outcome. This shortcoming is all the more important given the draft IRP proposes that MWD become responsible for, or compete with many local projects that are currently within the jurisdiction of cities, local agencies and groundwater managers. The 1994 Blue Ribbon Task Force made similar observations about the then-pending IRP process:

> "Although both the IRP and rate structure efforts largely 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." -- Blue Ribbon Task Force Report (BRTF Report) at page 8.

> "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." -- BRTF Report at page 12.

> "Despite a heavy meeting schedule, and numerous specialized committees and subcommittees, the Board often seems to be presented with limited options and choices for final approval largely defined and developed by MWD staff, rather than conduct an independent inquiry of relevant matters." -- BRTF Report at page 74.

These observations are as accurate regarding the current draft IRP and IRP process as they were more than 15 years ago. The 2010 draft IRP has been available for public review only recently, and although voluminous, contains limited information. The revised draft IRP will apparently not be available until later in September, with board adoption scheduled for October. This schedule and process does not allow for meaningful distribution or review of the draft IRP by those who are impacted through the adoption of the IRP. MWD staff has been portraying the draft IRP as implementation of the will of the people, rather than as a recommendation of MWD staff. But, of the almost 19 million people who live and work in Southern California, less than 350 people attended the four stakeholder workshops combined – and, many of those participants were MWD and member agency staff and consultants. Moreover, the stakeholders were being asked to comment on a draft report in which fundamental questions remain to be answered.

Given that MWD is proposing to change its historic role as imported water supplier – which is the principal responsibility most local agencies now associate with MWD – it is vitally important that sufficient time be allowed for distribution to city councils, county board of supervisors, groundwater managers, replenishment districts, water districts, utilities, and other local entities which will bear the expense of, or otherwise be impacted by MWD's new role. MWD and its member agencies should not simply assume that all agencies and stakeholders will welcome this new role for MWD or the associated rate increases that will be necessary to implement this course of action.

RECOMMENDATIONS

MWD uses the IRP as a foundation for its RUWMP. Thus, the draft IRP should reflect the clear professional recommendation of MWD staff. Is that the case? If so, we recommend you say so when the revised draft IRP is released. As it stands in the draft IRP, this is unclear.

At a minimum, we recommend that MWD provide a full 60-day review period between the release of a revised draft IRP, including responses to all comments and questions, and the first MWD board meeting to consider the revised draft. We also recommend at least two public meetings of the board to consider and deliberate the revised draft IRP. This time frame would still allow adoption of the IRP in advance of the RUWMP. Although the update process stated more than a year ago, the recommendations were made available for the first time in July 2010 when draft report was posted online. We were quite surprised with the recommended strategy, especially since the draft's own data indicates the excessiveness of such a recommendation. The draft recommends an adaptive strategy that included three components: Core Resources Strategy, Buffer Implementation, and Foundational Actions.

The draft IRP clearly indicated that the implementation of the Core Resources Strategy would meet projected dry-year demands under all foreseeable hydrologic conditions, with MWD's 5 million acre-feet of average storage capacity above 60 percentile and probability of dry-year shortage diminishing to zero past 2015 (with only than less than 1 percent shortage in 2015). Yet, it recommends moving forward with all three components concurrently, including aggressively pursuing Buffer Supply implementation (in contrast to 2004 IRP's planning buffer) and at the same time developing large-scale projects so they are "ready to proceed" under Foundational Actions.

The forthcoming revised draft IRP must integrate member agency plans and projects into the discussion, and before implementation of projects that exceed demand, member agencies' commitment to pay for these supplies must be obtained and proper choice and structure be set in place to ensure MWD does not strand water nor investments under the new supply strategy.

ATTACHMENT 3 – QUESTIONS POSED AT SAN DIEGO IRP FORUM

RELIABILITY GOALS

- Doesn't the IRP's reliance on the almost 60 year old Laguna Declaration – drafted at a time when Southern California was almost completely dependent on imported water – send the wrong message in today's limited resource and escalating cost environment? Is that a smart message in the water bond campaign?
- Why didn't MWD reconsider the central question of the where the regional reliability goal should be set?
- Why should everyone have to pay for the same reliability standard if they want to conserve more and pay less?
- How has MWD accounted for the dampening effect higher prices will have on water demand?

SUPPLY AND PLANNING BUFFER

- Has MWD done a survey of each of its member agencies and other local agencies and utilities to determine what projects they are developing now or plan to develop in the near future? Don't you need this kind of information in order to determine what supply "gap" exists?
- Will MWD staff agree to collect this information about local projects development and make it available before asking the board to adopt this IRP?
- What is the rationale for an MWD Buffer Supply equal to 10% of retail demand? What is that number based on?
- What is MWD's assumption in the IRP about who will pay for the core and Buffer supplies? Is there a breakdown of this by region or project? Isn't this information necessary to define even broad parameters of a real plan?
- Is staff recommending the implementation of both core and Buffer supplies because it does not believe it will be successful in the Delta Fix? If not, why does this draft recommend moving forward now with implementation of both supplies?
- Can you be more specific about the risks and uncertainties you believe justify the expenditure of current ratepayer dollars? What are the "trigger points" that would warrant increased spending?
- What is the level of commitment to developing the resources identified in the Buffer? And is there a certain date by which those resources will be developed?
- Why are recycled water and seawater desalination identified as part of the Buffer supplies?
- What is the size and composition of the Buffer?
- What is the process by which the region will make the decision to deploy elements of the Buffer? And are there risks associated with each trigger level?

MWD'S ROLE

- Isn't our current water supply allocation the result of challenges to our imported supplies? Since this has been MWD's historical role, shouldn't MWD focus its efforts and regional dollars on securing the Delta Fix and filling the Colorado River Aqueduct?

MEMBER AGENCY'S ROLE

- Does the IRP assume and recognize that the 20x2020 requirement is a retail obligation? Given that, why should MWD subsidize member agencies to meet this local mandate? Isn't this rewarding bad behavior?
- What is the IRP assumption about the project cost that would qualify for a financial "incentive" from MWD?
- Won't MWD by definition be investing in the most expensive sources of supply? [*Comment: If not, why would the local agency need an "incentive"?]*
- How does Met intend to ensure fairness among its member agencies in the collection and redistribution of incentive money for conservation and local projects?

PROJECT ASSUMPTIONS

- What is MWD's assumption on who will implement the 20x2020 mandate?
- What are MWD's planning assumptions for the on-line dates for the member agency projects described in the Appendix?
- What are MWD's assumptions for supply conditions under normal and wet years?
- What assumptions does the report make about how surplus water in any given year will be used? Will it go first to refill MWD's storage? Do you assume that discounted replenishment rates will be available at any time in the future? If so, under what conditions?

COST ANALYSIS

- What are the cost assumptions for core and Buffer Supply projects?
- What is the estimated rate impact as a result of implementing the core strategies? Is this impact based on an assumption the current rate structure remains unchanged?
- What would the implementation of Buffer Supply add to water rates?
- What about the Foundational Actions? How much would those activities add to water rates?
- Will MWD do a new rate structure analysis and cost of service study for IRP programs and projects before adopting the IRP?
- How does MWD ensure its core supply investments would not be stranded?
- Is MWD going to require firm contractual commitments from each of its member agencies to pay for all of this supply development?
- How do preferential rights relate to the availability of Buffer Supply water? Are they enforceable if a member agency claims them?
- Do you have any analysis available to show the "balancing" between resource investment and cost considerations?

TIMING

- IRP sets forth MWD's policy for future supply development and is an especially important document given changed water supply environment. Why the rush to get the report adopted so quickly?
- Are you willing to recommend extending the time for MWD staff to answer our questions before we are required to comment further on the report?

THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Manager

RECEIVED
AUG 30 2010
GENERAL MANAGER

August 25, 2010

Ms. Maureen A. Stapleton
General Manager
San Diego County Water Authority
4677 Overland Avenue
San Diego, CA 92123

Dear Ms. Stapleton:

Notice of Intent to Initiate Process to Consider
Termination of Incentive Agreements with the Water Authority

The agreements listed below between Metropolitan and the San Diego County Water Authority (Water Authority) contain provisions allowing The Metropolitan Water District of Southern California (Metropolitan) to file a 90-day notice of intent to consider terminating agreements should the Water Authority file litigation challenging Metropolitan's rate structure. In June 2010, the Water Authority initiated litigation challenging Metropolitan's water rates and charges for fiscal year 2010/11. Consequently, Metropolitan's Board of Directors at its August 17, 2010, meeting directed staff to initiate the process outlined in the rate structure integrity provisions.

Incentive Program	Existing Agreement	Number
Conservation	Regional Commercial Program	66654
Conservation	Regional Residential Program	78189
Enhanced Conservation	Landscape Auditor Interns	011-2006
Enhanced Conservation	Smart Landscape Grant Program Expansion	024-2007

This letter is the official 90-day notice of Metropolitan's intent to consider termination of the above listed agreements between Metropolitan and the Water Authority.

Within 30 days of receipt of this notice, the Water Authority has the right to request, in writing, mediation of the dispute by a neutral third party with expertise in finance and rate setting. The request for mediation would serve to stay the 90-day notice of intent to terminate, but for no more than 90 days beyond the filing of the notice of request for mediation. If the termination process advances, Metropolitan's Board of Directors will ultimately make the decision on whether to terminate the agreements. Payment of the incentives for this program will continue pending the decision by the Board following the 90-day notice period.

Metropolitan's Board of Directors also directed staff to defer execution of the following three agreements currently pending with the Water Authority, as termination proceedings would begin immediately upon execution:

Incentive Program	**Pending Agreement**	**Number**
Conservation	Agricultural Conservation Program	113401
Innovative Conservation	Flow control valve research project	91694
Seawater Desalination	Carlsbad Seawater Desalination Project	70025

If you have any questions, please contact me at (213) 217-6211 or via email at jkightlinger@mwdh2o.com.

Very truly yours,

Jeffrey Kightlinger
General Manager

WAT:jc
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cc: Board of Directors
Executive Secretary

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

December 9, 2010

Brian Thomas
Assistant General Manager/Chief Financial Officer
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Dear Mr. Thomas:

We reviewed Appendix A of MWD's Draft Official Statement, distributed to members of the Board of Directors on November 24, 2010 for an upcoming bond sale. We have a number of concerns. A principal concern is that the Draft Statement does not disclose MWD's present and future reduction in water sales due to a variety of key facts.

2010 Integrated Resources Plan

The recently adopted 2010 IRP articulated a new untested business strategy for MWD that is different than the historical role it has played in importing supplemental water supplies to Southern California. The implementation of this strategy would result in an overdevelopment of supplies by at least 200,000 acre-feet in 2020 and as much as 500,000 acre-feet per year through the overdevelopment of local supplies – either by MWD directly, or developed in concert with MWD subsidies. This new strategy has significant cost implications that have not been adequately described in the IRP or disclosed in the Draft Official Statement and could result in reduced sales rather than increased sales by MWD in the future. We described our concerns in our October 11, 2010 letter to MWD (copy attached and incorporated herein by reference). The 2010 IRP showed an MWD demand ranging from 1.67 million acre-feet to 1.75 million acre-feet in 2015, depending on how aggressively MWD would pursue local resources development. MWD demand is projected to be even lower in 2035 at between 1.35 million acre-feet and 1.65 million acre-feet. These are significant projected reductions in MWD sales. The Draft Statement fails to adequately disclose this fact.

Moreover, a month after MWD's board adopted the 2010 IRP, MWD staff released new water sales projections as part of its Long Range Finance Plan that show even lower potential sales by 2020, in a range from of a low of 1 million acre-feet, a high of 2

million acre-feet and a "projected expected" sales of 1.6 million acre-feet. The financial impact on MWD of 400,000 to 500,000 acre-feet of lower sales represented by the "projected expected" forecast is significant, and MWD must reconcile this major discrepancy in its Appendix A.

In addition to these concerns, MWD must analyze and disclose applicable limitations on its ability to fund local projects anticipated by the IRP under its existing rate structure, and, subject to the new Constitutional limitations under Proposition 26 as recently passed by California voters.

Projected Water Sales

The projected sales for the near term are overstated given current and reasonably anticipated water sales. After a series of steep rate hikes (increasing Tier 1 Treated Rate by 55 percent between 2008 and 2012), water management actions including aggressive conservation messaging, cessation of discounted replenishment water sales, phasing out of the agricultural program rate, and the implementation of M&I water allocation, MWD has significantly lowered its water demand. For the 10-year period of 2000-2009, MWD's annual water sales averaged 2.17 million acre-feet. This calendar year, MWD's sales are projected to equal a multi-decade low of about 1.5 million acre-feet – nearly 700,000 acre-feet below past decade's average (and 1 million acre-feet below its peak sales year) and importantly, 250,000 acre-feet below MWD's budgeted amount. Staff reported just last month that MWD's current year revenue is expected to be $120 million less than budgeted due to declining sales. This will put ever-increasing pressure to raise rates even higher, if not in CY 2012, then in following years.

We do not believe it is reasonable to assume MWD water sales will return to the 2 million acre-feet level in the time frame noted in the Official Statement, or, that it has the water supplies available to sustain sales in this range continuously. Moreover, as noted above, the implementation of the IRP could actually result in further reduction in MWD's own water sales.

Use of Bond Proceeds and Need for Funds

Given today's extraordinary upward rate pressure, and downward water sales trends, it is unclear why MWD is considering selling bonds at this time. We were informed by staff just last month due to lower water sales, MWD would be drawing down about $100 million from its Rate Stabilization Fund to help cover the impacts of low sales, resulting in reserves that are lower than the Board's established minimum level. We should be reviewing all expenditures, including scrubbing the Capital Investment Program, to reduce rate pressure. Selling the bonds now would result in MWD needing to expend the money within the specified time – that does not make sense. MWD needs to first figure

out what its new CIP expenditures should be in the current fiscal situation, and sustained lower water sales before committing itself to spending additional funds.

In conclusion, we believe MWD's exposure to sustained lower water sales is significant due to factors such as challenges to MWD's supplies, implementation of SBX7-7, the adoption of the 2010 IRP, and high water rates' impact on consumer demand; these factors must be disclosed in detail. As such, we request that the Draft Statement be modified to ensure MWD provides adequate disclosure to potential investors.

Thank you.

Sincerely,

Keith Lewinger
Director

Attachment

Cc: MWD Board of Directors
Jeff Kightlinger, General Manager
MWD Member Agency Managers

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

October 11, 2010

Timothy Brick
Chairman of the Board
Metropolitan Water District of Southern California
P. O. Box 54153
Los Angeles, CA 90054-0153

Re: Adoption of 2010 Integrated Resources Plan Update – OPPOSE

Dear Chairman Brick:

We reviewed the final draft 2010 Integrated Resources Plan Update (Final Draft), made available by MWD on October 1, and proposed to be adopted at the October 12, 2010 board meeting. We regret to inform you that we cannot support the Final Draft. Although the Final Draft corrected certain data inconsistencies in the prior draft, it fails to address the Water Authority's substantive concerns stated in its September 10, 2010 letter, a copy of which is attached and incorporated by reference. We renew the comments described in our September 10 letter and offer the following brief supplemental comments on some of the key issues.

Reliability Objective. The supply reliability objective is proposed to be expanded from meeting 100% of full-service demands at the retail level under all foreseeable hydrologic conditions to include an additional 500,000 acre-feet of water supply to be developed as an "Uncertainty Buffer." Despite the report stating that the 2010 IRP reliability is "true" to the reliability goal established under the prior IRPs, the implementation of an Uncertainty Buffer raises the reliability objective far beyond the prior IRPs. We do not believe that this reliability objective would be adopted by the board if it had been provided with accurate information regarding the cost for exceeding 100% reliability, and how high water rates will have to go to achieve this objective.

Cost. We have previously commented on the dearth of information provided to the board regarding the true cost of IRP implementation. The board memo transmitting the Final Draft says only that a reliable water supply will "come at a cost" and states that, historically, the *national* cost of water and sewer maintenance has increased at a rate of 2 percent above inflation. It goes on to state that projections in the IRP "show that MWD's future rate increases would be at or below these historic norms for the industry." This statement is misleading at best and is inconsistent with *actual rate increases* MWD has experienced over the past few years – when it was not embarked upon the kind of spending program described in the IRP.

Over the last five years alone (2008-2012), MWD has increased its rates by almost 55% -- or an average of 11% per year. With these rate increases, MWD has put its water rates in uncharted territory, where it is completely disconnected from historical CPI averages. In a presentation on MWD's Long Range Finance Plan just one week ago (Oct. 4), MWD staff projected rate increases averaging 6 percent per year over the next 10 years -- but that figure does not include *any* spending associated with implementing the local Uncertainty Buffer water supply projects contemplated in the IRP. Moreover, many of the cost assumptions used to develop the rate impact analysis are conspicuously low. From 2008 to 2020, MWD projects that it will more than doubled its water rates (increasing its untreated Tier 1 rate from by 144 percent, from $351 to $857 an acre-foot), and again, those projections do not include any costs for implementing IRP local Uncertainty Buffer water supply projects. In its public outreach on the IRP, MWD staff did not inform the public or stakeholders that it expects to more than double water rates by 2020, and that those water rate increases will be further exacerbated by the additional over-investment in IRP supply projects. Because this information was not accurately disclosed in the IRP, it also does not provide a substantive analysis of the impact these rate increases will have on demand and MWD sales. Again, we reiterate that this IRP is not a financially sustainable plan for MWD's future.

Conservation and Water Use Efficiency. The Final Draft includes within the Core Resources Strategy retail compliance with water use efficiency targets mandated by SBX 7-7. However, it relegates the 200,000 acre-feet of regional water use efficiency to the "Uncertainty Buffer." Both conservation targets should be included as part of the Core Resources Strategy. The Final Draft mischaracterizes the 200,000 acre-feet of increased regional water use efficiency as an "Uncertainty Buffer." Increasing conservation should not be a "buffer," but rather, it should be foundational to the plan. Because of the mischaracterization, the Final Draft proposes to over-develop 200,000 acre-feet more of Core Resources Strategy projects than would be necessary to meet projected demands. If MWD indeed plans to immediately begin implementing the 200,000 acre-feet of regional water use efficiency programs (and the Final Draft states it will be fully implemented by 2020), then it must reduce the dry-year demand target in the Core Resources Strategy on an acre-foot for acre-foot basis. This would mean reducing the dry-year demand target in the Core Resources Strategy from 1.81 million acre-feet per year (in 2035) to 1.61 million acre-feet. Consistent with this action, investments in supply projects identified in the Core Resources Strategy could be reduced to account for the 200,000 acre-feet of lower demand, resulting in a lower forecast for water rates. In order to develop programs for the procurement of cost-effective efficiency supplies, MWD must send accurate pricing signals regarding the cost of its current water supply and future water supply resources. A thoughtful consideration of this subject would require substantial revisions to the IRP as it is now proposed for adoption.

Water Supply Allocation and Long-Term Conservation Plan Development and Coordination. The Long Term Conservation Plan (LTCP) draft recently distributed to member agency staff states that it will establish a new direction for MWD conservation programs and be amended to conform to the IRP. The LTCP draft further anticipates that the IRP would specify MWD and member agencies' respective roles in achieving the conservation targets. The Final Draft,

however, does not suggest any substantive changes in MWD conservation programs, nor does it address MWD and member agencies' respective responsibilities in meeting the target.

MWD must also change its Water Supply Allocation Plan so that water conservation is verified, recognized and rewarded as part of the supply allocation. In spite of past opposition at MWD, measurement and verification are essential components of successful water use efficiency programs. A fresh look at MWD's water conservation programs might also be tied into the IRP targets for the Bay Delta and other water supply resources within the core resources strategy. We hope to work with MWD staff and stakeholders to reform MWD's long term conservation program to support these outcomes. A copy of our August 16, 2010 letter on the subject of MWD's LRCP is attached and incorporated herein by reference.

CEQA. MWD staff has stated that CEQA review of the IRP Update is not required because the IRP is not a document that controls future decision-making in a manner that could result in the possibility of a significant effect on the environment. However, MWD staff has also stated that it intends to take immediate action to implement projects and programs identified in the draft IRP should it be adopted by the Board.

The Final Draft makes it apparent that MWD views the IRP as a controlling policy document that is the first step in the implementation of a major new direction for MWD, including a new water supply program, which warrants full environmental review before the MWD board votes to approve the IRP. This is a point we previously made to Brian Thomas in our September 22 letter regarding the draft official statement and we reiterate it here. A copy of our September 22, 2010 letter is attached and incorporated herein by reference.

Lack of MWD Response to Comments on the IRP Provided in Letters and Stakeholder Forums. MWD received numerous comment letters from other agencies and stakeholders whose questions have not been answered, nor their concerns addressed by the Final Draft, including a host of questions asked by the Water Authority's member agency managers during the Stakeholder Forum conducted in San Diego. We seriously question the need to move forward now with adoption of the Final Draft when answers to important questions have not been provided. Moreover, no time has been allowed for its distribution to, or consideration by the hundreds of cities, counties, agencies, taxpayers and water ratepayers who will be affected by the IRP.

In closing, we would like to reiterate that the San Diego County Water Authority fully supports investments in water supply reliability for Southern California. However, a real plan is needed for MWD that reflects the ongoing efforts of MWD member agencies and others to develop cost-effective local water supplies to replace imported water supplies previously available from MWD. MWD should focus its efforts on what should be its core competency – finding workable solutions for a Delta Fix as soon as possible. MWD's recently announced intention to venture into the local water supply development business will unnecessarily drive up costs for all purchasers of MWD imported water supplies and invite controversy at every step of the way.

On behalf of the San Diego delegation, and for the reasons stated in this letter, we do not support the Final Draft 2010 IRP, or its adoption by the board of directors at the October board meeting.

Sincerely,

Fern Steiner

Attachment 1: Water Authority's comment letter on 2010 IRP Update dated September 10, 2010
Attachment 2: Water Authority comment letter on MWD Water Conservation Program dated August 16, 2010
Attachment 3: Water Authority's comment letter on MWD's draft official statement dated September 22, 2010

cc: MWD Board of Directors
Jeff Kightlinger, General Manager
Water Authority Board of Directors
Mayor Jerry Sanders
San Diego County Taxpayers Association
Industrial Environmental Association
San Diego County Farm Bureau
San Diego Regional Chamber of Commerce
San Diego Regional Economic Development Corporation

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

September 10, 2010

Jeffrey Kightlinger
General Manager
Metropolitan Water District of Southern California
PO Box 54153
Los Angeles, CA 90054-0153

Re: 2010 Integrated Resources Plan Update

Dear Jeff:

Water Authority staff has completed its review of the draft 2010 Integrated Resources Plan Update (draft IRP). We plan a broader outreach effort to our region's cities, stakeholders and communities once we have complete information and a revised draft IRP document. Given that the current draft IRP has only been available since July, and since the revised draft won't be available until sometime later in September, we reiterate our request that the October timeline for adoption of the IRP be extended to allow for broader distribution of the revised draft IRP here and in other parts of the MWD service territory. This outreach should then be followed by additional public meetings of MWD's board so that the merits of the revised draft IRP can be fully deliberated in a transparent setting after MWD responds to all the current comments and questions.

Changed Circumstances

The water supply and cost environment have fundamentally changed since the IRP was last updated in 2004. Twenty percent water conservation is now legally required at the retail level by 2020. Replenishment deliveries by MWD have been interrupted indefinitely. Severe cutbacks of water supplies from the Bay-Delta are now a way of life for the foreseeable future. We must plan for impacts of climate change. As a result of these and other changed circumstances – and taking into account the reasonably anticipated cost of a Delta Fix – conservation and local projects that once warranted subsidies have become cost effective compared to MWD's current and projected water rates. For this reason, many of the more than 250 retail water agencies and cities in the MWD service territory are now in the process of expanding conservation programs and developing local water supply projects.

Although the draft IRP refers generally to some of these changed circumstances, it does not recommend any changes in the basic MWD business model to address them. The draft IRP plan essentially assumes the same base resource mix and adds a massive, undefined "Buffer Supply" to mitigate undefined and unquantified uncertainties. Instead of asking how it may best *coordinate, encourage and integrate* with planned conservation and local water supply development that is already under way throughout the service territory, MWD proposes to embark on a massive spending program.

Stranded Costs and Stranded Historic Imported and Low Cost Water

MWD's IRP strategy will drive MWD's rates up drastically and lead to lower water sales by MWD as local agencies develop lower-cost supply alternatives. With the Buffer Supply strategy in the draft IRP, MWD is setting itself up for a perfect storm of skyrocketing water rates and plummeting water sales. This course of action amounts to a fiscal death-spiral for MWD and is financially unsustainable.

While it is not possible to determine from the draft IRP precisely what the current core supplies are or how the proposed Buffer Supply will be developed as MWD projects and member agency projects (or any iteration thereof), one thing is very clear from the draft IRP: *MWD is embarking on a course of action that will result in abandonment of MWD's historic investments in water supply infrastructure and low-cost core water supplies in favor of far more expensive water.* A graph illustrating this practical effect of the IRP is included as Attachment 1 to this letter. That graph shows that MWD's Buffer Supply strategy will lead to 500,000 acre-feet of imported water being stranded by MWD each year, in favor of more expensive local supplies developed by MWD at a cost of more than $1 billion annually on MWD's rates (2035). <u>It is imperative that MWD take the time now to refine this draft IRP to avoid creating stranded water and the associated stranded costs we will be asking our ratepayers to cover for decades to come.</u>

Detailed Comments on July Draft IRP

Our detailed comments are included in Attachment 2 to this letter in the following broad subject matter categories:

- *Water Rate Impacts*
- *Conservation*
- *Commitment to the Delta*
- *Stranded Costs*
- *Why Abandon Historic Investments and Low Cost Water?*
- *Respect for Local Autonomy*
- *Definition of Region*
- *Outdated Reliability Goal*
- *Need to Integrate Member Agency and Local Planning Data*
- *Failure to Identify Key Issues to Maximize Surface Storage, Groundwater Storage and Conjunctive Use*
- *The Problem with Water Insurance, aka "Buffer Supply"*
- *"Adaptive Management" Inadequately Defined*
- *Inaccurate and Incomplete Data*
- *Process Concerns*
- *Recommendations*

We met with our member agency managers to obtain their perspectives, comments and questions. The August 10 IRP forum in San Diego was well attended by our agency managers and many questions and comments were presented to you directly at that time. A list of those questions is included as Attachment 3 to this letter.

We request that MWD staff distribute a revised draft IRP once it has an opportunity to respond to comments and questions raised here and at the IRP Stakeholder Forums, and to review and reconcile the data in the report so that it is both internally consistent and consistent with MWD's Regional Urban Water Management Plan.

Please let us know what the timeline is for receiving your written responses to this letter and the questions asked at the IRP Stakeholder Forums. We hope to work with you to complete an IRP that will provide a solid roadmap for the future for all of Southern California.

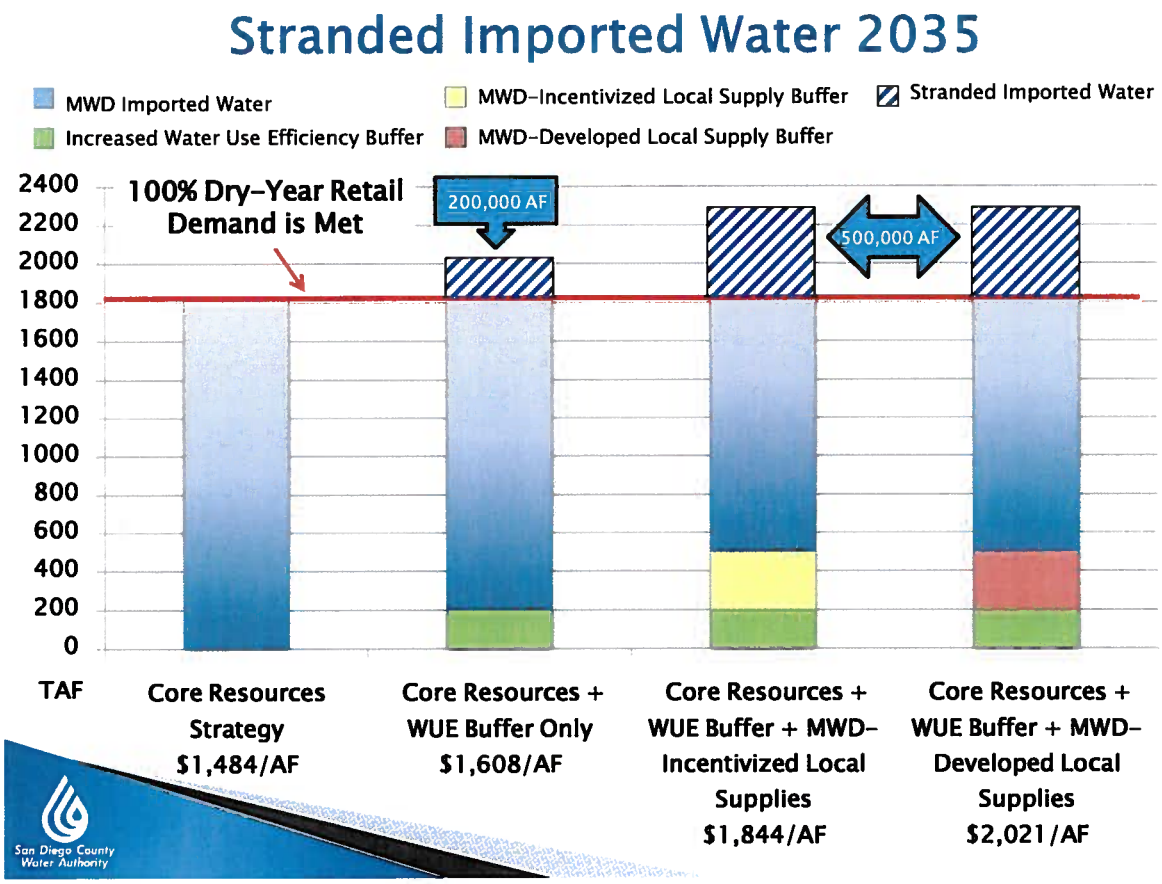
Sincerely,

Maureen A. Stapleton
General Manager

Attachment 1: Stranded Imported Water in 2035
Attachment 2: Comments on MWD's July Draft 2010 IRP Update
Attachment 3: Questions posted at San Diego IRP Forum

cc: MWD Board of Directors
MWD Member Agency Managers
Water Authority Board of Directors
Water Authority Member Agency Managers

ATTACHMENT 1– STRANDED IMPORTED WATER IN 2035



ATTACHMENT 2 – COMMENTS ON MWD'S JULY DRAFT 2010 IRP UPDATE

WATER RATE IMPACTS

With the unprecedented recommendation to develop 25% more water than MWD demands require, the draft IRP is extremely light on its analysis of potential rate impacts. The only rate analysis included in the draft was a table in Section 3 prepared for the board's strategic policy discussion and not related to the recommendation to implement the Buffer Supply. Presumably, the supplies being developed under the Core Resources Strategy would generally be lower in cost than those under Buffer and Foundational Actions. The implementation of the Buffer Supply will require substantial financial investment by MWD and its member agencies. A critical analysis of potential rate impacts and the impact rate increases will have on demand must be completed and deliberated by the board before it takes a policy direction on the IRP and implementation of a Buffer Supply.

In mid-August, MWD's staff presented a "2010 IRP Average Rate Analysis" on four implementation strategies for the IRP. The presentation showed the difference in the rate increase between the Core Resources Strategy – one that MWD admits meets all projected dry-year demand – and the plan's recommended strategy to develop 500,000 acre-feet of additional Buffer Supplies is only 2 percent, a deceptively and alluringly low number that obscures the actual difference in cost ratepayers would experience between implementing the Core Resources Strategy and any one of the three Buffer Supply strategies. The difference amounts to up to $537 per acre-foot in 2035 – a 36% difference in water rates in that year; this is not insignificant.

More troublesome, however, are some of the assumptions that went into the rate analysis. MWD currently funds about $20 million for its water conservation programs, which it projects would result in about 10,000 acre-feet of new conservation annually. Both the 20x2020 retail mandate and 20x2020 regional consistency require investment far beyond the current conservation effort. Under the 20x2020 regional consistency analysis, staff estimated 580,000 acre-feet of water use efficiency beyond that anticipated through current conservation programs is needed. Yet, only $20 million is assumed in the analysis to achieve the conservation goal that is significantly higher than what the current investment is producing. Similarly, the rate impact for Buffer implementation assumes MWD continues the $250 acre-foot subsidy for local projects development at the same time it is proposing investments in local water supply development that greatly exceed this cost. Another example: in the MWD-Developed Buffer Supply scenario wherein MWD assumes financial responsibility for 500,000 acre-feet of conservation and local supply development, MWD's operations would surely grow, yet the rate analysis shows zero cost difference in the Departmental O&M from the Core Resources Strategy; this appears to be an unrealistic assumption. Another example: zero cost has been assigned to account for the project development costs and risks associated with the Foundational Actions component of the plan.

MWD's failure to calculate or acknowledge the true cost of water by basing the rate impact analysis on unrealistic assumptions does a disservice to Southern California ratepayers and only pushes the hard decisions to another day. We request that a more realistic set of cost assumptions be used to conduct the rate analyses associated with the IRP and that this information be available for full discussion and deliberation by MWD's board of directors.

CONSERVATION

The Water Conservation Act of 2009 (the Conservation Act, or 20x2020) established new methodologies, water use targets and reporting requirements. The Act's requirements apply to urban *retail water suppliers*. Although MWD and its wholesale member agencies have a supporting role, primary responsibility for compliance with the law falls to each retail agency within MWD's service territory. The draft IRP does not address these requirements or explain how a regional program would integrate with, or support these retail conservation programs.

MWD's recent board memo on water conservation concluded that accounting for conservation at the individual member agency level would be too difficult and would threaten the efficacy of MWD's Integrated Resources Plan, Water Supply Allocation Plan and other programs. We respectfully disagree, and point out that local agencies already do so as part of their Urban Water Management Plans (and other plans). It is imperative that the MWD board consider changed circumstances and legal requirements to ensure that any future regional conservation program integrates with local programs, and avoids creating conservation disincentives through the pricing structure, water supply allocation plan, or otherwise.

While the draft IRP appears to *assume* a regional compliance approach, the Conservation Act provides that urban retail water suppliers must achieve and report compliance on an individual basis unless certain prerequisites for regional compliance and reporting are met. Among other things, regional compliance requires the written consent of each retail agency. MWD should factor this legal requirement into its analysis in the revised draft IRP.

Indeed, as a wholesale water provider, MWD's role in conservation must be carefully evaluated in light of these new legal requirements. Since it is unlikely that all retail water suppliers within MWD's service territory will elect to report as part of MWD's regional water management group, MWD must account for that as the regional program is being developed. MWD must carefully assess how a regional program can fairly integrate with the individual programs its member agencies, and their respective retail agencies, choose to implement to ensure that each retail agency and group of ratepayers is carrying its legally required, fair share of the cost.

Changes will also be necessary to MWD's water shortage allocation plan in order to encourage conservation. The City of Long Beach has presented a number of ideas and approaches to address this concern that should be thoroughly evaluated and considered. We also believe that MWD's wholesale price structure discourages conservation by disguising the true cost of alternative water supplies. By continuing to offer regional subsidies to retail agencies to meet water use efficiency targets that are legally required of them, MWD is actually discouraging water conservation – unless, that is, MWD pays for it. Any regional program must <u>start where the legal requirement on the retailers *ends*</u>, otherwise, MWD is simply robbing Peter to pay Paul and rewarding free riders. And, by subsidizing compliance with the retail 20x2020 targets, funds that MWD collects from some of its member agencies will be benefitting (subsidizing) compliance of other member agencies while providing no commensurate benefit to the "donor" agencies, because those donor agencies do not receive "credit" toward their own 20x2020 compliance goals for spending money (via the MWD subsidies) in other retailers' service areas.

These donor agencies must additionally spend their own rate money to meet their own compliance requirement.

As noted earlier, we believe that measurement and verification are essential to any water use efficiency program, and is in fact, required for compliance. We would note that the data MWD uses to support the conservation section of the IRP is, except for the current demographic data from SCAG and SANDAG, outdated (Attachment A.1, Attachment C-2) (1997). One of the recommendations in the 1997 report was that MWD expand the coverage of its conservation data base to include the many MWD member agencies with respect to which conservation data was not available. (See IRP Attachment A-1 at Attachment C-40)

We believe there is an important role for MWD in water conservation but that its programs must change in order to address the concerns described above. The draft IRP fails to address these important considerations.

COMMITMENT TO THE DELTA

Many agencies and stakeholders are reading the draft IRP recommendation to "immediately" and "aggressively" implement 500,000 acre-feet of Buffer Supply as a signal that MWD is abandoning, or does not believe that it will be successful in fixing the Delta. This comes as a big surprise to our community, which worked tirelessly on the 2009 water bill package and water bond. We do not support changing course and believe that we must diligently pursue and protect our investment in the Delta and State Water Project. The Delta Community is also counting on our continued support. It is our understanding from the information provided by MWD that the Core Resources Strategy includes both a Delta Fix and continuation of existing Colorado River programs contemplated by the Quantification Settlement Agreement. We believe this is the correct approach and consistent with MWD's core mission.

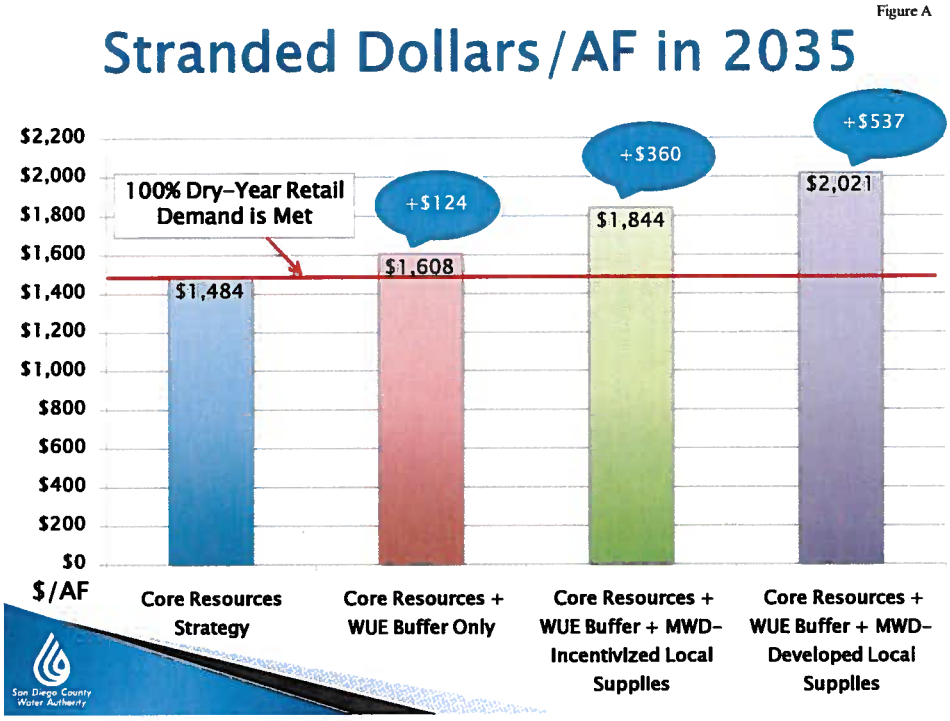
This having been stated, the Water Authority is open to having a candid discussion with MWD, the Delta Community and all interested parties about the nature and extent of the Delta "Fix," if MWD has grown skeptical of the prospects for success in the Delta. In the meantime, and unless and until a *conscious decision* is made – with the benefit of analysis and input from all affected parties – we believe the call for a Buffer Supply sends the wrong message vis-à-vis MWD's intentions in the Delta – and an expensive message at that.

STRANDED COSTS

Since the drought in the early 1990's, MWD's water management strategy has been to invest in storage to take advantage of the hydrologic cycles to best utilize low-cost, available water. Today, this investment, which stands in excess of 5 million acre-feet of storage capacity, has served the region well during the current supply challenges. But, rather than continuing this management strategy to optimize the historic investment in the State's water supply infrastructure and MWD's own low-cost imported water, the draft IRP proposes to shift course in favor of MWD developing local water supplies at a high cost to its ratepayers.

The development of the Buffer Supplies would lead to a similar outcome. If these supplies are not needed – and the draft indicates that demands for the Buffer Supplies will not exist – then the costs to develop them are truly in excess of need and stranded and, therefore, will be stranded costs. A graphic illustration of the stranded costs is shown below in Figure A.

Figure A



It is important that MWD integrate its planning with those of its member agencies so that it does not find itself with stranded investments and future unexpected rate increases due to poor planning.

WHY ABANDON HISTORIC INVESTMENTS AND LOW COST WATER?

Staff's rate analysis released in mid-August sheds light on the following facts: the immediate implementation of Buffer Supply, whether limited to regional consistency Water Use Efficiency of 200,000 acre-feet or the entire 500,000 acre-feet inclusive of local projects would result in abandonment of like amounts of lower-cost imported water, even after it has obligated its share of the Delta Fix improvements. Case in point, in 2035, with Buffer Supply inclusive of Water Use Efficiency only, MWD's own rate analysis showed it would forgo a like amount of imported water due to reduction in sales. The situation worsens if MWD implements the entire 500,000 acre-feet of Buffer Supply, under both MWD-Incentivized and MWD-Developed Buffer Supply scenarios, 500,000 acre-feet of imported water is forgone. Why would MWD spend billions of dollars to develop new supplies and, at the same time, plan to forego use of those supplies?

RESPECT FOR LOCAL AUTONOMY

The key question addressed in the draft IRP focuses on the "role" of MWD. But, with due respect, we believe it's the wrong question. The focus should not be on MWD's "role," but on how the most reliable, cost-effective water supply can be provided to water ratepayers, being

mindful that not every retail water supplier or even every "region" within the vast MWD service territory will answer that question the same way. MWD's "top-down, all-in" planning model in which it will assume responsibility over local water supply development fails to take into account the many cities, local agencies and groundwater managers who grapple with local water supply development issues every day. It is an open question what role these agencies and water suppliers would like MWD to play, but it is certainly important to ask. Historically, the answer to that question would be easy: they want funding to help support local water supply development. We believe that there *is* a role MWD can play in helping to support local projects including funding mechanisms for local supply development. But the rules must be firm and fair, laid out in advance, and equitable to all parties.

DEFINITION OF REGION

Given the dramatic shift in the draft IRP from imported water supplier to local supply developer, MWD should take a step back and ask itself, its member agencies and, critically – the hundreds of cities, counties, water suppliers, groundwater managers and other local districts – how they define their "region" for purposes of local water supply development. MWD has been Southern California's principal "regional" *imported* water supplier. That does not mean that it will be efficient or even logical for MWD to become Southern California's "regional" *local* water supplier. The State, for example, recognizes nine separate IRWM planning groups that are wholly or partially within the MWD service territory. What makes sense for "regional" local water supply development needs to be discussed between and among all interested parties, not just MWD and its member agencies, and be defined in a manner that is practical, workable and equitable to all parties. It is likely that not all local and regional agencies desire to be under the planning umbrella of MWD and its member agencies – whose member agencies often have goals, priorities and objectives that are different than their own.

OUTDATED RELIABILITY GOAL

By declaring allegiance to the 1952 Laguna Declaration, the draft IRP misses a critical opportunity to signal that it is no longer "business as usual" in Southern California or at MWD. Indeed, where and how to establish the reliability goal was not even discussed as part of the IRP process. In today's water-scarce, high-rate environment, our customers want a choice about the level of "regional" reliability they want to pay for.

But the draft IRP goes even further, it advocates a reliability goal of developing core supplies to meet full-service dry year demands at the retail level under all foreseeable hydrologic conditions, *plus* developing a Buffer Supply of 10% of retail demand, *plus* completing project planning for an array of additional projects based on undefined "uncertainty" (the Foundational Actions). This "Laguna Declaration-*Plus*" approach is excessive, impractical and fiscally imprudent. It also flies in the face of California's changed circumstances and Southern California's conservation ethic.

Before staff recommends the highly aggressive supply development outlined in the draft IRP, it should communicate with each of its member agencies to determine the extent to which those

agencies intend to rely upon MWD to meet their future supplemental water supply needs. As aptly noted in the 1994 Blue Ribbon Task Force Report,

> "[It was troubling] to learn, for example, that some of the member agencies most strongly supporting big-ticket projects...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 customers." -- BRTF Report at page 23.

Just as in the past, it is clear that some of the MWD member agencies most strongly supporting the draft IRP are doing so precisely because they believe that it will allow them to become <u>less dependent upon MWD</u>.

NEED TO INTEGRATE MEMBER AGENCY AND LOCAL PLANNING DATA

The draft IRP identifies the need for only 16,000 acre-feet of local projects to achieve the Core Resources Strategy target in 2015 and only 46,000 acre-feet by 2025 and through the end of the planning horizon (2035). According to the draft IRP, this will result in 100% supply reliability under all hydrologic conditions to meet dry-year demand. It is important to note that in reaching the 100% reliability assessment, the plan has taken into account regulatory and environmental constraints on supplies from the Bay-Delta in the years before mid- and long-term Delta improvements are completed.

Based upon review of the limited data included in Appendix A.5 of draft IRP, it appears that as much as 750,000 acre-feet of local water supply is already being planned by MWD member agencies. It is unclear whether this list includes all supply projects that are being planned by cities, groundwater managers, replenishment districts, utilities and other agencies and water suppliers throughout Southern California. Given that the draft identifies only 46,000 acre-feet of local projects is needed to achieve Core Resources strategy's 100% reliability goal, the draft IRP fails to grapple with the reality that MWD sales will be <u>reduced, not increased</u> in the future. If properly coordinated, this trend can be a positive outcome for MWD and all of Southern California. But MWD threatens to disrupt the positive economic impacts of this shift by proposing to over-invest in new water supplies in an ill-fated and illusory attempt to increase its own sales. Failure to coordinate with the many cities, water districts, and utilities beyond MWD member agencies places all Southern California water ratepayers at risk.

The draft IRP also does not provide projected supplies under average- and wet-year hydrologic conditions and their frequencies of occurrence. The draft shows only how MWD's storage would fare under "average" conditions. Figures 4-5 and 4-6 reflect very healthy storage conditions for MWD, but lack data for member agencies to assess how their surface reservoir or groundwater basins could be augmented for dry year use.

In summary, although the IRP by definition is intended to be an *integrated* plan that takes member agency and retail supply plans into account as part of MWD's regional planning, the

IRP draft fails to do so. This presents grave risk to MWD and Southern California water ratepayers.

Finally, MWD's historic and principal role has been to deliver water to Southern California imported from the Colorado River and State Water Project. The subsidy programs were originally created to "encourage" conservation and development of local water supplies that were otherwise not cost-effective, and, in order to "send the right message" to Northern California where it was seeking to maintain its State Water Project entitlement. The rationale was that by supporting these local water supply investments, the costs of securing additional imported water supplies and/or infrastructure were "avoided," and thus the payment of MWD subsidies benefited the region as a whole. MWD should take the time now as part of the IRP planning process to consider the appropriate role of subsidies generally, and including whether subsidies are encouraging or impeding desired outcomes.

FAILURE TO IDENTIFY KEY ISSUES TO MAXIMIZE SURFACE STORAGE, GROUNDWATER STORAGE AND CONJUNCTIVE USE

The draft IRP says that Metropolitan has "gradually shifted from being exclusively a supplier of imported water to collaborating with its member agencies on regional water supply planning issues." This statement does not capture the momentous change that is being recommended for adoption in the draft 2010 IRP, which will place MWD in control of planning, outreach, all state and federal funding and decision-making about local project development. While the draft promises that MWD will "collaborate" with agencies outside of their own member agencies, it appears that it has not collaborated with them in proposing this new role for MWD in the first place. Willingness to allow MWD to become the regional master facilities planner may also vary by region.

MWD's principal, historic role has been as a supplemental, imported wholesale water supplier to its member agencies. While "collaboration" with its member agencies is indeed important, MWD is announcing in the draft IRP a substantially different and enhanced role for itself in the future, including "master planning" for significant local water supply resources over which it has no legal jurisdiction or expertise. The draft IRP does not so much represent a "gradual shift" as a takeover strategy for local water supply development in which MWD will be in charge of local water supply development through its regional master planning process. For example, MWD is declaring that it will be in charge of "master planning" for the following activities:

1. Recycled water development, including creation of a regional finance committee that will determine how all state and federal funding dollars are best spent (Table 5-5);
2. Preparation of salt management plans and groundwater basin management plans (Table 5-7);
3. Seawater desalination "integration" (Table 5-10) and funding mechanisms (Table 5-13); and,
4. Stormwater capture, including regional master planning, implementation of pilot projects and development of subsidy programs (Table 5-19).

MWD's newly announced role as "master planner" for all Southern California local water supply development goes far beyond the function of "collaboration" described above. Given that it has little expertise in groundwater and developing local projects, staffing and budget increases will undoubtedly be on the horizon. These efforts will duplicate those of the many local water suppliers, replenishment districts and groundwater managers who are already engaged at the local level.

In lieu of these proposed changes, MWD should follow the same, more cautious guidelines it suggests for graywater (see page 5-36), namely,

1. Do not establish subsidies to pay for graywater;
2. Focus instead on reviewing and suggesting standards and pursuing changes to legislation and regulations to support graywater development;
3. Work with local entities to create model guidelines for permitting processes; and,
4. Assist with public information efforts as requested and appropriate.

Finally, the draft IRP fails to address the most fundamental questions that must be addressed by MWD at the wholesale level, including: 1) how available imported water supplies will be managed; and 2) what policies are needed to assure fair access to facilities in order to move water stored in groundwater basins in and out of, and within the MWD distribution system.

THE PROBLEM WITH WATER INSURANCE, AKA "BUFFER SUPPLY"

The draft IRP recommends implementation of the Buffer Supply as an insurance policy against uncertainties, but does not provide a quantitative analysis or risk assessment to show how the 500,000 acre-feet of supply development was derived. For this reason, the Buffer Supply is purely speculative.

The Buffer Supply is also financially unsustainable under the current rate structure, since agencies would only pay for the "insurance" when they file a "claim" for the water. The cost of maintaining a large "standby" supply will be extraordinarily expensive, force MWD rates to increase exponentially, and, drive water purchasers away from MWD in search of lower cost supplies that they can control. Here again, the 1994 Blue Ribbon Task Force had it right:

> "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." -- BRTF Report at page 9.

While the draft IRP itself is silent on the cost of the Buffer Supply, MWD's mid-August rate analysis showed startling costs of the Buffer Supply, in terms of sky-high water rates, stranded water supply and stranded costs. The two charts included with these comments were developed based upon this mid-August rate analysis.

Furthermore, the draft IRP appears to ignore the fact that MWD already has a substantial "Buffer" in which it has invested, namely, MWD's vast storage program. MWD has 5 million acre-feet of storage, which the draft IRP indicates will be full on average. The draft IRP also says that if the Core Resources Programs are implemented, the region could have an excess of 1 million acre-feet of water during dry years, when storage and transfers are factored in. If the 500,000 acre-feet Buffer Supply is implemented, *without* MWD taking any water from its storage, the region will have more water than required to meet demands including filling all available storage. The bottom line is that the draft IRP fails to factor in that the very purpose of the existing storage is to provide the same dry year assurance that is proposed to be filled by the new Buffer Supply.

"ADAPTIVE MANAGEMENT" INADEQUATELY DEFINED

Although the draft IRP says that MWD will employ an "adaptive management" strategy, the draft also concludes that an aggressive approach to immediately implement the Buffer Supply is required. In general, it is not possible to discern from the draft IRP what the timing or "triggers" are for any of the "adaptive" actions. The draft IRP is also inconsistent with statements made by MWD staff at the August 10 San Diego Stakeholders Forum with regard to timing of adaptive management actions described in the draft IRP.

At its own August 20 member agency managers' meeting, MWD staff stated that it plans to only recommend immediate implementation of the regional consistency Water Use Efficiency Buffer, and leave the implementation of the Local Resources Buffer to occur only when certain trigger events take place, such as failure to obtain the environmental documentation for a Delta conveyance facility by a date-certain (yet to be specified). This is a very different position than the draft's aggressive approach to implement local projects as delineated within the draft IRP as follows:

> Page 4-20, "Implementing a Supply Buffer," states, in part: "...a 'planning' Buffer was introduced during the 2004 Update. The 2010 IRP Update proposes to expand the concept of a planning Buffer and <u>create an actual hedge</u> against demand uncertainty, by <u>implementing</u> a supply Buffer equivalent to 10 percent of total retail demand. Metropolitan will collaborate with the member agencies to <u>implement</u> this Buffer through complying with the 20X2020 legislation, and by <u>implementing aggressive</u> adaptive actions to meet any remaining portion of the 10 percent Buffer." (Emphasis added.)
>
> On page ES-8, the draft states: "Maximizing regional benefits through economies of scale and minimizing the cost of redundancy is important to adaptability. The 2010 IRP Update <u>will</u> hedge against demand, supply and environmental uncertainties by <u>implementing</u> a supply Buffer equivalent to 10 percent of total retail demand. This Buffer <u>will be implemented</u> through meeting 20X2020 water use efficiency goals, and by <u>implementing aggressive adaptive actions</u> to meet the remaining portion of the 10 percent Buffer through local supplies and transfers. This approach is consistent with maintaining reliable baseline supplies and advancing local and regional solutions." (Emphasis added.)

> In its outreach materials used at the IRP Public Forums, MWD has an executive summary, page ES-10, that states the Buffer Supply will be "...developed through collaboration with the member agencies on aggressive actions." And, on Figure ES-4, Component 2 box reads "aggressive adaptive actions for the remainder." (Emphasis added.)

It is impossible to reconcile the oral comments made by MWD staff at the August 10 Stakeholder Forum and the August 20 MWD Member Agency Managers meeting with the conflicting verbiage in the draft IRP document.

It is also completely unclear what "adaptive management" means or how it will be employed by the MWD staff once the IRP is adopted by the board. Substantially more detailed planning and transparency is required before board adoption so that the member agencies can better understand what is intended by the draft IRP.

INACCURATE AND INCOMPLETE DATA

The Core Resources Strategy is the heart of MWD's current water supply planning. It is essential that the draft IRP provide a full description of the components of the Core Resources Strategy. And yet, it is not possible to discern the details of the Core Resources Strategy due to the fact that there is inconsistent data presented throughout Sections 4 and 6 of the draft IRP. These are the key sections of the report that present analyses of the available water supplies and need to develop additional supplies.

To ensure a sustainable resource plan that clearly outlines a path for long-term reliability, it is fundamental that the draft IRP start with a more comprehensive evaluation of the Core Resource Strategy. The Core Resource Strategy serves as the foundation of the plan. The analysis should include an identification of what actions can be taken to strengthen the core strategy in order to maximize investments already made in imported supplies. The evaluation should include an assessment that clearly identifies the risks associated with implementation of the core strategy and takes adaptive measures to mitigate those risks. This assessment would provide a linkage between the Core Resource Strategy and the timing and type of adaptive management strategies recommended. Transparency in the process is critical to providing the member agencies the data and information needed to plan accordingly in their UWMP and resource plans.

In addition to the internal inconsistencies, the data included in the draft IRP is also inconsistent with data included in MWD's recently released draft Regional Urban Water Management Plan (RUWMP). The Water Authority suggests that MWD staff conduct a workshop with the member agency managers to work through this detail so that MWD's Core Resources Strategy can be presented in a manner that may be better understood and inconsistencies with MWD's RUWMP can be reconciled.

To cite just a few examples, seawater desalination is listed as existing production on Table 4-6 but as a yet-to-be-developed Core Resource on Table 4-8. There is no indication how the groundwater, local surface water and Los Angeles Aqueduct (LAA) supplies listed in Table 4-7 were projected. And, it is unclear why there is an increase in groundwater supplies during this

planning horizon, but a decrease in surface water. The data for LAA also differs between the IRP and RUWMP. These and other inconsistencies and lack of foundational data are not "details" to be "worked out later" – rather, this is foundational information required in order to meaningfully assess MWD's current supplies and the need to develop additional supplies.

Beyond the internal inconsistencies in the draft IRP, there is also insufficient information provided on the plans of cities, groundwater agencies, replenishment districts, utilities and water suppliers throughout the Southland to implement conservation and other local water supply programs that will substantially reduce the amount of water purchases from MWD in the future. While the draft notes that there are approximately 250 retail agencies that supply water to the public, the draft IRP analysis has failed to account for the plans and timing of plans that many of these 250 retail agencies have to both conserve water and develop local resources. Although Appendix A.5 includes a list of member agency area projects, it does not provide analysis to show how these projects will reduce the demand for MWD supplies. It also does unclear whether it includes projects of the many agencies, sub-agencies and utilities who presently buy water from MWD member agencies. MWD must work with its member agencies to develop an accurate and agreed upon list of projects as well as project timing, and eliminate inconsistencies before it finalizes the draft IRP.

Moreover, MWD's methodology limits its accounting of local supplies to existing, under construction and "committed" projects (a term not defined in the draft IRP). All other planned local projects are included as part of MWD's own "regional" target, with the explanation that, "... [t]his recognizes the uncertainty in local supplies and avoids over and under allocating local supply targets to individual agencies" (see Appendix A.1-22, "Projected Active Conservation: A New Approach). This approach appears grounded in MWD's past experience and the notion that local water suppliers cannot be relied upon to develop local supplies and, therefore, MWD must step in and take over responsibility for local supply development. This assumption fails to take into account the substantially changed circumstances and that many local water supply projects that were once uncompetitive with the price of imported water are now cost-effective – without any subsidies from MWD – when compared to even the conservatively projected cost of MWD water. There are also better mechanisms to hold local water suppliers accountable to the region for completion of projects than the theoretical no-cost or low-cost water supply Buffer "insurance" recommended in the draft IRP.

The realistic regional demand "gap" cannot reasonably be estimated without taking into account the existing and planned actions of MWD's member agencies and other local water suppliers. The draft IRP notes that Metropolitan has historically provided between 45 and 60 percent of the municipal, industrial, and agricultural water used within its service area. However, enhanced conservation and development of local water supplies will result in a dramatic reduction in water demand on MWD. Implementing any of the Buffer Supply strategies in the draft IRP will lead to unavoidably higher rates and inversely declining sales.

PROCESS CONCERNS

While there have been a large number of meetings and IRP-related "processes," the process overall has been both "top down" and "disintegrated," with no meaningful opportunity for non-MWD member agency participants to shape the outcome. This shortcoming is all the more important given the draft IRP proposes that MWD become responsible for, or compete with many local projects that are currently within the jurisdiction of cities, local agencies and groundwater managers. The 1994 Blue Ribbon Task Force made similar observations about the then-pending IRP process:

> "Although both the IRP and rate structure efforts largely 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." -- Blue Ribbon Task Force Report (BRTF Report) at page 8.

> "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." -- BRTF Report at page 12.

> "Despite a heavy meeting schedule, and numerous specialized committees and subcommittees, the Board often seems to be presented with limited options and choices for final approval largely defined and developed by MWD staff, rather than conduct an independent inquiry of relevant matters." -- BRTF Report at page 74.

These observations are as accurate regarding the current draft IRP and IRP process as they were more than 15 years ago. The 2010 draft IRP has been available for public review only recently, and although voluminous, contains limited information. The revised draft IRP will apparently not be available until later in September, with board adoption scheduled for October. This schedule and process does not allow for meaningful distribution or review of the draft IRP by those who are impacted through the adoption of the IRP. MWD staff has been portraying the draft IRP as implementation of the will of the people, rather than as a recommendation of MWD staff. But, of the almost 19 million people who live and work in Southern California, less than 350 people attended the four stakeholder workshops combined – and, many of those participants were MWD and member agency staff and consultants. Moreover, the stakeholders were being asked to comment on a draft report in which fundamental questions remain to be answered.

Given that MWD is proposing to change its historic role as imported water supplier – which is the principal responsibility most local agencies now associate with MWD – it is vitally important that sufficient time be allowed for distribution to city councils, county board of supervisors, groundwater managers, replenishment districts, water districts, utilities, and other local entities which will bear the expense of, or otherwise be impacted by MWD's new role. MWD and its member agencies should not simply assume that all agencies and stakeholders will welcome this new role for MWD or the associated rate increases that will be necessary to implement this course of action.

RECOMMENDATIONS

MWD uses the IRP as a foundation for its RUWMP. Thus, the draft IRP should reflect the clear professional recommendation of MWD staff. Is that the case? If so, we recommend you say so when the revised draft IRP is released. As it stands in the draft IRP, this is unclear.

At a minimum, we recommend that MWD provide a full 60-day review period between the release of a revised draft IRP, including responses to all comments and questions, and the first MWD board meeting to consider the revised draft. We also recommend at least two public meetings of the board to consider and deliberate the revised draft IRP. This time frame would still allow adoption of the IRP in advance of the RUWMP. Although the update process stated more than a year ago, the recommendations were made available for the first time in July 2010 when draft report was posted online. We were quite surprised with the recommended strategy, especially since the draft's own data indicates the excessiveness of such a recommendation. The draft recommends an adaptive strategy that included three components: Core Resources Strategy, Buffer Implementation, and Foundational Actions.

The draft IRP clearly indicated that the implementation of the Core Resources Strategy would meet projected dry-year demands under all foreseeable hydrologic conditions, with MWD's 5 million acre-feet of average storage capacity above 60 percentile and probability of dry-year shortage diminishing to zero past 2015 (with only than less than 1 percent shortage in 2015). Yet, it recommends moving forward with all three components concurrently, including aggressively pursuing Buffer Supply implementation (in contrast to 2004 IRP's planning buffer) and at the same time developing large-scale projects so they are "ready to proceed" under Foundational Actions.

The forthcoming revised draft IRP must integrate member agency plans and projects into the discussion, and before implementation of projects that exceed demand, member agencies' commitment to pay for these supplies must be obtained and proper choice and structure be set in place to ensure MWD does not strand water nor investments under the new supply strategy.

ATTACHMENT 3 – QUESTIONS POSED AT SAN DIEGO IRP FORUM

RELIABILITY GOALS

- Doesn't the IRP's reliance on the almost 60 year old Laguna Declaration – drafted at a time when Southern California was almost completely dependent on imported water – send the wrong message in today's limited resource and escalating cost environment? Is that a smart message in the water bond campaign?
- Why didn't MWD reconsider the central question of the where the regional reliability goal should be set?
- Why should everyone have to pay for the same reliability standard if they want to conserve more and pay less?
- How has MWD accounted for the dampening effect higher prices will have on water demand?

SUPPLY AND PLANNING BUFFER

- Has MWD done a survey of each of its member agencies and other local agencies and utilities to determine what projects they are developing now or plan to develop in the near future? Don't you need this kind of information in order to determine what supply "gap" exists?
- Will MWD staff agree to collect this information about local projects development and make it available before asking the board to adopt this IRP?
- What is the rationale for an MWD Buffer Supply equal to 10% of retail demand? What is that number based on?
- What is MWD's assumption in the IRP about who will pay for the core and Buffer supplies? Is there a breakdown of this by region or project? Isn't this information necessary to define even broad parameters of a real plan?
- Is staff recommending the implementation of both core and Buffer supplies because it does not believe it will be successful in the Delta Fix? If not, why does this draft recommend moving forward now with implementation of both supplies?
- Can you be more specific about the risks and uncertainties you believe justify the expenditure of current ratepayer dollars? What are the "trigger points" that would warrant increased spending?
- What is the level of commitment to developing the resources identified in the Buffer? And is there a certain date by which those resources will be developed?
- Why are recycled water and seawater desalination identified as part of the Buffer supplies?
- What is the size and composition of the Buffer?
- What is the process by which the region will make the decision to deploy elements of the Buffer? And are there risks associated with each trigger level?

MWD'S ROLE

- Isn't our current water supply allocation the result of challenges to our imported supplies? Since this has been MWD's historical role, shouldn't MWD focus its efforts and regional dollars on securing the Delta Fix and filling the Colorado River Aqueduct?

MEMBER AGENCY'S ROLE

- Does the IRP assume and recognize that the 20x2020 requirement is a retail obligation? Given that, why should MWD subsidize member agencies to meet this local mandate? Isn't this rewarding bad behavior?
- What is the IRP assumption about the project cost that would qualify for a financial "incentive" from MWD?
- Won't MWD by definition be investing in the most expensive sources of supply? [*Comment: If not, why would the local agency need an "incentive"?]*
- How does Met intend to ensure fairness among its member agencies in the collection and redistribution of incentive money for conservation and local projects?

PROJECT ASSUMPTIONS

- What is MWD's assumption on who will implement the 20x2020 mandate?
- What are MWD's planning assumptions for the on-line dates for the member agency projects described in the Appendix?
- What are MWD's assumptions for supply conditions under normal and wet years?
- What assumptions does the report make about how surplus water in any given year will be used? Will it go first to refill MWD's storage? Do you assume that discounted replenishment rates will be available at any time in the future? If so, under what conditions?

COST ANALYSIS

- What are the cost assumptions for core and Buffer Supply projects?
- What is the estimated rate impact as a result of implementing the core strategies? Is this impact based on an assumption the current rate structure remains unchanged?
- What would the implementation of Buffer Supply add to water rates?
- What about the Foundational Actions? How much would those activities add to water rates?
- Will MWD do a new rate structure analysis and cost of service study for IRP programs and projects before adopting the IRP?
- How does MWD ensure its core supply investments would not be stranded?
- Is MWD going to require firm contractual commitments from each of its member agencies to pay for all of this supply development?
- How do preferential rights relate to the availability of Buffer Supply water? Are they enforceable if a member agency claims them?
- Do you have any analysis available to show the "balancing" between resource investment and cost considerations?

TIMING

- IRP sets forth MWD's policy for future supply development and is an especially important document given changed water supply environment. Why the rush to get the report adopted so quickly?
- Are you willing to recommend extending the time for MWD staff to answer our questions before we are required to comment further on the report?

San Diego County Water Authority
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August 16, 2010

Timothy Brick
Metropolitan Water District of Southern California
PO Box 54153
Los Angeles, CA 90054-0153

Re: August 2010 Board Memo 9-1, MWD Water Conservation Program

Dear Tim:

Board Memo 9-1 addresses what is described as an "opt in/opt out" approach for MWD's water conservation program. The memo concludes that accounting for conservation at the individual member agency level would be too difficult and would threaten the efficacy of MWD's Integrated Resources Plan, Water Supply Allocation Plan and other programs. Although we strongly support increased conservation, we respectfully disagree with the analysis and conclusions stated in the Board Memo. The MWD board must consider changed circumstances and legal requirements to ensure that any future regional program integrates with local programs, and, avoids creating conservation disincentives through the pricing structure, water supply allocation plan, or otherwise.

The Water Conservation Act of 2009 (the Conservation Act) established new methodologies, water use targets and reporting requirements. The Act's requirements apply to urban ***retail water suppliers***. Although MWD and its wholesale member agencies have a supporting role, primary responsibility falls to each retail agency within MWD's service territory. The board memo does not address these requirements or explain how a regional program would integrate with or support these retail conservation programs.

Although the Board Memo appears to *assume* a regional compliance approach, the Conservation Act provides that urban retail water suppliers must achieve and report compliance on an individual basis unless certain prerequisites for regional compliance and reporting are met. Among other things, regional compliance requires the written consent of each retail agency.

As a wholesale water provider, MWD's role in conservation must be carefully evaluated in light of these new legal requirements. Since it is unlikely that all retail water suppliers within MWD's service territory will elect to report as part of MWD's regional water management group, MWD must account for that as the regional program is being developed. MWD must carefully assess how a regional program can fairly integrate with the individual programs its member agencies choose to implement to ensure that each retail agency and group of ratepayers is carrying its lawful and equitable share of the cost.

Turning to some of the other key issues, we believe that changes in MWD's water shortage allocation plan are necessary to encourage further conservation. The City of Long Beach has presented a number of ideas and approaches to address this concern. We also believe that MWD's wholesale price structure discourages conservation by disguising the true cost of alternative water supplies. By continuing to offer regional subsidies to retail agencies to meet conservation targets that are already required, MWD is actually discouraging water conservation. This element of the current plan creates free riders, and, fails to ensure that each member agency pays its fair share or that all MWD water ratepayers are treated fairly.

As noted earlier, the board memo also states that water conservation at the member agency level would be difficult to quantify and measure and could be labor intensive in verification; however, we believe that measurement and verification are essential to any water use efficiency program, and is in fact, required for compliance.

Finally, the board memo states that consideration of different approaches to conservation would require MWD to reconsider its message under the Laguna Declaration. The Laguna Declaration has been included in the IRP draft as a statement that MWD will provide all of the water anyone needs at any time under any hydrologic condition. But we believe the Laguna Declaration is not a reason to refuse to consider changes in MWD's conservation program. To the contrary, we believe that MWD *should* reconsider whether the Laguna Declaration properly reflects California law and public policy, or, Southern California's conservation ethic. Our ratepayers have said that they want a choice whether to conserve more in lieu of paying for 100% water supply reliability 100% of the time. It is imperative that MWD work with its member agencies to ensure that we can offer them that choice.

We would like to reiterate that the Water Authority strongly supports increased conservation. We believe there is an important role for MWD but that MWD's water conservation program must change in order to address the concerns described in this letter.

Sincerely,

Fern Steiner on behalf of the Water Authority's MWD Delegation

cc: MWD Board of Directors
SDCWA Board of Directors

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September 22, 2010

Brian Thomas
Assistant General Manager/Chief Financial Officer
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Dear Brian:

On the afternoon of September 16, you distributed to members of the Board of Directors Appendix A of MWD's Draft Official Statement for an upcoming refunding bond sale and asked for comments to be submitted by noon today; given the tight deadline, we limit our comments in this letter and the attachments to only the most significant issues and concerns with Appendix A. These comments are presented to you by the four of us as directors representing the San Diego County Water Authority. We request that you respond to the questions presented in this letter and make the necessary modifications to Appendix A of the Official Statement before it is finalized and issued. We believe additional time is warranted to schedule a full board review of the issues noted in this letter and in our IRP Comment Letter discussed below.

2010 Integrated Resources Plan

On page A-3, fourth paragraph, MWD makes only passing reference – and does not disclose key facts – about its 2010 Integrated Resources Plan Update. The document states that the IRP "…is expected to be completed in late 2010." In fact, the IRP is expected to be presented by MWD staff to the Board of Directors for adoption at its October 12, 2010 meeting – only 13 days after the initiation of bond sales covered by this Official Statement. Appendix A fails to disclose material facts about the 2010 IRP that should be disclosed to potential investors, including but not limited to MWD's plan to develop so-called "buffer" water supplies in the amount of up to 500,000 acre-feet per year, at a cost of billions of dollars over the next 25 years. On September 10, 2010, the Water Authority submitted to MWD extensive comments on the IRP. A copy of that letter is attached and the questions and comments incorporated herein (IRP Comment Letter). We request that MWD provide a substantive discussion in Appendix A regarding potential legal and financial implications from the shift from MWD's historic role as a supplemental imported water supplier to local water supply developer; that identifies the breadth of the IRP implementation strategies under consideration, and the extent of costs and future water rates that would be necessary to implement the IRP recommendation. Appendix A should also include a discussion – here and elsewhere – on the effects higher water rates are expected to have on MWD sales. Experience over the past several years clearly shows a nexus between sharply higher water

rates and conservation (demand reduction) by customers (ratepayers). MWD should disclose the impacts of its IRP strategies that would lead to water rates exceeding $2,000 an acre-foot by 2035 if not sooner and the impacts increasing water rates would have on water demands on MWD. Further, as discussed at length in the IRP Comment Letter, how will MWD ensure that there will be customers to pay for its regional local water supply projects when so many agencies are in the process of developing local water supply projects of their own for which their retail customers will pay through retail water rates. This concern should also be discussed in connection with the renewal of purchase orders at page A-1.

We are also concerned that the discussion is misleading about the purpose and importance of the IRP in the development and implementation of the "Preferred Resource Mix." Responding to questions about the necessity of CEQA review prior to adoption of the draft IRP update, MWD staff has stated that such review is not required because the IRP is not a document that controls future decision-making in a manner that could result in the possibility of a significant effect on the environment. However, MWD staff has also stated that it intends to take immediate action to implement projects and programs identified in the draft IRP should it be adopted by the Board. When viewed in its entirety, the discussion of the IRP and the Preferred Resource Mix suggest the IRP is viewed by MWD as a controlling document that would be the first step in the implementation of a major new supply program and would be subject to CEQA. If this is not the case, MWD must make that clear and should also provide assurance that CEQA compliance will be accomplished before any actions are taken to implement any of the programs or projects contemplated as part of the draft IRP's Supply Buffer.

Seawater Desalination Project Subsidies

On page A-4 and again on page A-31, under *Seawater Desalination*, MWD mischaracterizes the Carlsbad seawater desalination project and the status of the incentive payment agreement with MWD relating to this project. MWD also fails to disclose the fact that MWD has initiated termination proceedings on incentive payment agreements with the Water Authority and its member agencies, and, that it is MWD that has refused to sign the Carlsbad Seawater Desalination Project agreement approved by its own board on November 10, 2009.

In the Seawater Desalination Sections of Appendix A on Pages A-4 and A-31, Metropolitan addresses the status of member agency agreements for incentive funding for seawater desalination projects, including the Water Authority's incentive funding agreement. Metropolitan states that "SDCWA has not executed the proposed agreement." This statement would mislead the reader to conclude that but for SDCWA's execution, the agreement would be in effect today. That is not true. The Water Authority's incentive funding agreement, approved by the Metropolitan Board on November 10, 2009 and by the Water Authority Board on December 17, 2009, includes rate structure integrity language that allows Metropolitan to terminate the agreement should the Water Authority file litigation to challenge Metropolitan's rate structure. Following the Water Authority's initiation of litigation in June 2010 (briefly discussed on page A-47) challenging Metropolitan's rates and charges, Metropolitan's Board initiated termination of existing Water Authority funding agreements that include rate structure integrity language. On August 25, 2010, in a letter to the Water Authority from Metropolitan's General Manager (attached), the Water Authority was notified that "Metropolitan's Board of Directors also directed staff to defer execution" of the Water Authority's seawater desalination incentive funding agreement "…as termination proceedings would begin

immediately upon execution." These facts regarding the Carlsbad Seawater Desalination Project agreement should be stated on pages A-4 and A-31.

Near-Term Delta Actions
On page A-25, under *Near-Term Delta Actions*, MWD discusses the potential supply benefit of the proposed Two-Gate System and other "near-term" actions to improve water supply and ecosystem of the Delta. However, MWD does not provide a timeline estimate of when it expects the Two-Gate project to be in place and producing improved supply reliability of approximately 150,000 acre-feet per year in certain years. We request an estimated operational date for the Two-Gate project be added to this discussion.

Five-Year Supply Plan
On page A-26, under *Local Resources*, MWD projects that 122,000 of additional, new supply could be online by 2014 from recycled water treatment plants, groundwater recovery plants, desalination plants and new hookups to existing recycled water plants. This figure seems optimistic based on the experience. If MWD indeed projects this level of implementation, it is not our belief that the costs associated with such level of local resources development have been included in the budget or water rates adopted for 2011 or 2012. We request that the estimated costs and associated water rate increases be added to this discussion. In addition, given the long lead time generally associated with the development of such projects, we believe MWD should describe the process by which it will be able to implement local projects of this magnitude within the timeline described in the O.S.

Significant Exposure to Reduced Sales
On page A-29, Appendix A describes a construction project that will provide an interconnection between the Antelope Valley-East Kern Water Agency and the Los Angeles Aqueduct. Under an agreement with MWD, the City of Los Angeles will be able to acquire and move into the LA Aqueduct supplies obtained independently of MWD. This section notes that the annual quantity of supplies moving into the LA Aqueduct through the interconnection is "…not to exceed the supplies lost to the City as a result of its Eastern Sierra environmental obligations, including water for the Lower Owens River Project and Owens Lake Dust Mitigation Project…." That amount, Appendix A notes, was 98,000 acre-feet from April 2009 to March 2010. However, MWD does not disclose that the City of Los Angeles currently purchases water used to offset the use of its own Eastern Sierra supplies for environmental purposes from MWD, and that the interconnection with AVEK will allow LA to reduce its purchase from MWD on an acre-foot-for-acre-foot basis. Reduction of sales by approximately 100,000 acre-feet per year will have a material effect on MWD revenues and on MWD's water rates. And yet, on page A-30, MWD asserts that the City of LA's "future reliance on Metropolitan supplies may increase with implementation of these (Eastern Sierra environmental) projects." The motivation for LA to pursue the interconnection with AVEK in the first place is its apparent belief that it can acquire independent supplies at a lower cost than MWD's supply cost. Therefore, in contrast to the statement on page A-30, it is more likely LADWP will acquire any additional environmental offset water needed from sources other than MWD.

Future Water Sales and Receipts
On Page A-69, and again at A-71 to A-72, MWD projects steady growth in water sales over the next five years from 1.77 million acre-feet in the current fiscal year (2011), to 2.11 million acre-feet in FY 2015, "…reflecting a return to average weather conditions." This projection appears to attribute the current low water demands on MWD (and reduced sales) to a single factor: weather. A return to

normal weather, the report implies, will result in returning sales to pre-shortage levels. No discussion or consideration is provided to what effect other factors –most notably higher water rates – have had, and continue to have in suppressing water demand and sales. The O.S. also fails to discuss or take into account the recently passed 20x2020 legislation requiring 20% conservation at the retail level. Appendix A should provide an analysis of the impacts higher water rates and conservation requirements are having on demand and sales, and factor those impacts into projections of future water sales (e.g. the next five fiscal years and beyond).

Page A-72 notes that because of lower-than-budgeted water sales in the current year (160,000 acre-feet lower than budgeted), MWD will make a draw of $34 million from its Water Rate Stabilization Fund. However, on September 17, 2010, at the MWD Member Agency Managers meeting, MWD management reported that the net draw from the Water Rate Stabilization Fund this year is projected to be $100 million. MWD should reconcile these two figures and ensure the number reflected Appendix A is the correct one.

We believe the comments contained in this letter and the attachments must be addressed through substantive modifications to Appendix A and request those changes be made to ensure MWD provide accurate and adequate disclosure to potential investors.

Thank you.

Sincerely,

Lynne L. Heidel

Lynne Heidel
Director

Keith Lewinger

Keith Lewinger
Director

Bud Pocklington

Bud Pocklington
Director

Fern Steiner

Fern Steiner
Director

Attachments

Cc: MWD Board of Directors
Jeff Kightlinger, General Manager

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September 10, 2010

Jeffrey Kightlinger
General Manager
Metropolitan Water District of Southern California
PO Box 54153
Los Angeles, CA 90054-0153

Re: 2010 Integrated Resources Plan Update

Dear Jeff:

Water Authority staff has completed its review of the draft 2010 Integrated Resources Plan Update (draft IRP). We plan a broader outreach effort to our region's cities, stakeholders and communities once we have complete information and a revised draft IRP document. Given that the current draft IRP has only been available since July, and since the revised draft won't be available until sometime later in September, we reiterate our request that the October timeline for adoption of the IRP be extended to allow for broader distribution of the revised draft IRP here and in other parts of the MWD service territory. This outreach should then be followed by additional public meetings of MWD's board so that the merits of the revised draft IRP can be fully deliberated in a transparent setting after MWD responds to all the current comments and questions.

Changed Circumstances

The water supply and cost environment have fundamentally changed since the IRP was last updated in 2004. Twenty percent water conservation is now legally required at the retail level by 2020. Replenishment deliveries by MWD have been interrupted indefinitely. Severe cutbacks of water supplies from the Bay-Delta are now a way of life for the foreseeable future. We must plan for impacts of climate change. As a result of these and other changed circumstances – and taking into account the reasonably anticipated cost of a Delta Fix – conservation and local projects that once warranted subsidies have become cost effective compared to MWD's current and projected water rates. For this reason, many of the more than 250 retail water agencies and cities in the MWD service territory are now in the process of expanding conservation programs and developing local water supply projects.

Although the draft IRP refers generally to some of these changed circumstances, it does not recommend any changes in the basic MWD business model to address them. The draft IRP plan essentially assumes the same base resource mix and adds a massive, undefined "Buffer Supply" to mitigate undefined and unquantified uncertainties. Instead of asking how it may best *coordinate, encourage and integrate* with planned conservation and local water supply development that is already under way throughout the service territory, MWD proposes to embark on a massive spending program.

Stranded Costs and Stranded Historic Imported and Low Cost Water

MWD's IRP strategy will drive MWD's rates up drastically and lead to lower water sales by MWD as local agencies develop lower-cost supply alternatives. With the Buffer Supply strategy in the draft IRP, MWD is setting itself up for a perfect storm of skyrocketing water rates and plummeting water sales. This course of action amounts to a fiscal death-spiral for MWD and is financially unsustainable.

While it is not possible to determine from the draft IRP precisely what the current core supplies are or how the proposed Buffer Supply will be developed as MWD projects and member agency projects (or any iteration thereof), one thing is very clear from the draft IRP: *MWD is embarking on a course of action that will result in abandonment of MWD's historic investments in water supply infrastructure and low-cost core water supplies in favor of far more expensive water.* A graph illustrating this practical effect of the IRP is included as Attachment 1 to this letter. That graph shows that MWD's Buffer Supply strategy will lead to 500,000 acre-feet of imported water being stranded by MWD each year, in favor of more expensive local supplies developed by MWD at a cost of more than $1 billion annually on MWD's rates (2035). <u>It is imperative that MWD take the time now to refine this draft IRP to avoid creating stranded water and the associated stranded costs we will be asking our ratepayers to cover for decades to come.</u>

Detailed Comments on July Draft IRP

Our detailed comments are included in Attachment 2 to this letter in the following broad subject matter categories:

- *Water Rate Impacts*
- *Conservation*
- *Commitment to the Delta*
- *Stranded Costs*
- *Why Abandon Historic Investments and Low Cost Water?*
- *Respect for Local Autonomy*
- *Definition of Region*
- *Outdated Reliability Goal*
- *Need to Integrate Member Agency and Local Planning Data*
- *Failure to Identify Key Issues to Maximize Surface Storage, Groundwater Storage and Conjunctive Use*
- *The Problem with Water Insurance, aka "Buffer Supply"*
- *"Adaptive Management" Inadequately Defined*
- *Inaccurate and Incomplete Data*
- *Process Concerns*
- *Recommendations*

We met with our member agency managers to obtain their perspectives, comments and questions. The August 10 IRP forum in San Diego was well attended by our agency managers and many questions and comments were presented to you directly at that time. A list of those questions is included as Attachment 3 to this letter.

We request that MWD staff distribute a revised draft IRP once it has an opportunity to respond to comments and questions raised here and at the IRP Stakeholder Forums, and to review and reconcile the data in the report so that it is both internally consistent and consistent with MWD's Regional Urban Water Management Plan.

Please let us know what the timeline is for receiving your written responses to this letter and the questions asked at the IRP Stakeholder Forums. We hope to work with you to complete an IRP that will provide a solid roadmap for the future for all of Southern California.

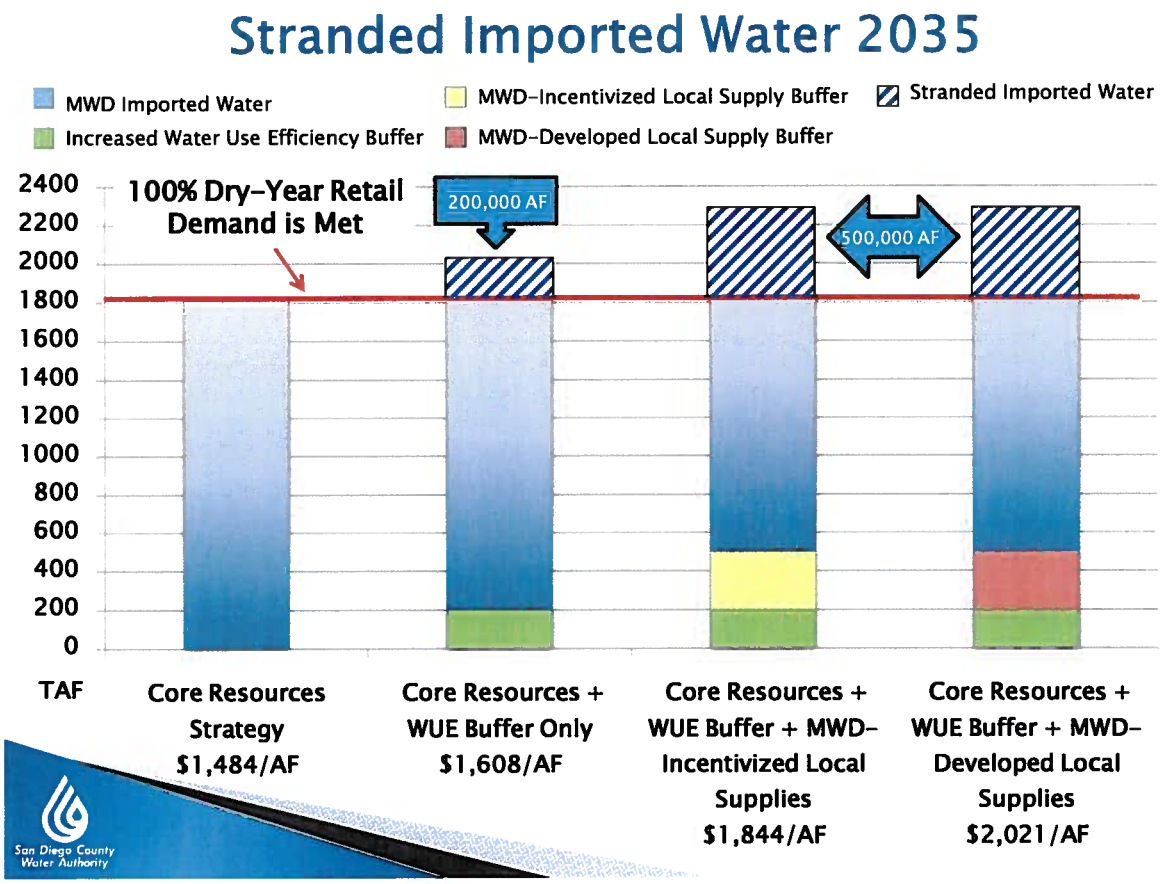
Sincerely,

Maureen A. Stapleton
General Manager

Attachment 1: Stranded Imported Water in 2035
Attachment 2: Comments on MWD's July Draft 2010 IRP Update
Attachment 3: Questions posted at San Diego IRP Forum

cc: MWD Board of Directors
MWD Member Agency Managers
Water Authority Board of Directors
Water Authority Member Agency Managers

ATTACHMENT 1– STRANDED IMPORTED WATER IN 2035



ATTACHMENT 2 – COMMENTS ON MWD'S JULY DRAFT 2010 IRP UPDATE

WATER RATE IMPACTS

With the unprecedented recommendation to develop 25% more water than MWD demands require, the draft IRP is extremely light on its analysis of potential rate impacts. The only rate analysis included in the draft was a table in Section 3 prepared for the board's strategic policy discussion and not related to the recommendation to implement the Buffer Supply. Presumably, the supplies being developed under the Core Resources Strategy would generally be lower in cost than those under Buffer and Foundational Actions. The implementation of the Buffer Supply will require substantial financial investment by MWD and its member agencies. A critical analysis of potential rate impacts and the impact rate increases will have on demand must be completed and deliberated by the board before it takes a policy direction on the IRP and implementation of a Buffer Supply.

In mid-August, MWD's staff presented a "2010 IRP Average Rate Analysis" on four implementation strategies for the IRP. The presentation showed the difference in the rate increase between the Core Resources Strategy – one that MWD admits meets all projected dry-year demand – and the plan's recommended strategy to develop 500,000 acre-feet of additional Buffer Supplies is only 2 percent, a deceptively and alluringly low number that obscures the actual difference in cost ratepayers would experience between implementing the Core Resources Strategy and any one of the three Buffer Supply strategies. The difference amounts to up to $537 per acre-foot in 2035 – a 36% difference in water rates in that year; this is not insignificant.

More troublesome, however, are some of the assumptions that went into the rate analysis. MWD currently funds about $20 million for its water conservation programs, which it projects would result in about 10,000 acre-feet of new conservation annually. Both the 20x2020 retail mandate and 20x2020 regional consistency require investment far beyond the current conservation effort. Under the 20x2020 regional consistency analysis, staff estimated 580,000 acre-feet of water use efficiency beyond that anticipated through current conservation programs is needed. Yet, only $20 million is assumed in the analysis to achieve the conservation goal that is significantly higher than what the current investment is producing. Similarly, the rate impact for Buffer implementation assumes MWD continues the $250 acre-foot subsidy for local projects development at the same time it is proposing investments in local water supply development that greatly exceed this cost. Another example: in the MWD-Developed Buffer Supply scenario wherein MWD assumes financial responsibility for 500,000 acre-feet of conservation and local supply development, MWD's operations would surely grow, yet the rate analysis shows zero cost difference in the Departmental O&M from the Core Resources Strategy; this appears to be an unrealistic assumption. Another example: zero cost has been assigned to account for the project development costs and risks associated with the Foundational Actions component of the plan.

MWD's failure to calculate or acknowledge the true cost of water by basing the rate impact analysis on unrealistic assumptions does a disservice to Southern California ratepayers and only pushes the hard decisions to another day. We request that a more realistic set of cost assumptions be used to conduct the rate analyses associated with the IRP and that this information be available for full discussion and deliberation by MWD's board of directors.

CONSERVATION

The Water Conservation Act of 2009 (the Conservation Act, or 20x2020) established new methodologies, water use targets and reporting requirements. The Act's requirements apply to urban *retail water suppliers*. Although MWD and its wholesale member agencies have a supporting role, primary responsibility for compliance with the law falls to each retail agency within MWD's service territory. The draft IRP does not address these requirements or explain how a regional program would integrate with, or support these retail conservation programs.

MWD's recent board memo on water conservation concluded that accounting for conservation at the individual member agency level would be too difficult and would threaten the efficacy of MWD's Integrated Resources Plan, Water Supply Allocation Plan and other programs. We respectfully disagree, and point out that local agencies already do so as part of their Urban Water Management Plans (and other plans). It is imperative that the MWD board consider changed circumstances and legal requirements to ensure that any future regional conservation program integrates with local programs, and avoids creating conservation disincentives through the pricing structure, water supply allocation plan, or otherwise.

While the draft IRP appears to *assume* a regional compliance approach, the Conservation Act provides that urban retail water suppliers must achieve and report compliance on an individual basis unless certain prerequisites for regional compliance and reporting are met. Among other things, regional compliance requires the written consent of each retail agency. MWD should factor this legal requirement into its analysis in the revised draft IRP.

Indeed, as a wholesale water provider, MWD's role in conservation must be carefully evaluated in light of these new legal requirements. Since it is unlikely that all retail water suppliers within MWD's service territory will elect to report as part of MWD's regional water management group, MWD must account for that as the regional program is being developed. MWD must carefully assess how a regional program can fairly integrate with the individual programs its member agencies, and their respective retail agencies, choose to implement to ensure that each retail agency and group of ratepayers is carrying its legally required, fair share of the cost.

Changes will also be necessary to MWD's water shortage allocation plan in order to encourage conservation. The City of Long Beach has presented a number of ideas and approaches to address this concern that should be thoroughly evaluated and considered. We also believe that MWD's wholesale price structure discourages conservation by disguising the true cost of alternative water supplies. By continuing to offer regional subsidies to retail agencies to meet water use efficiency targets that are legally required of them, MWD is actually discouraging water conservation – unless, that is, MWD pays for it. Any regional program must <u>start where the legal requirement on the retailers *ends*</u>, otherwise, MWD is simply robbing Peter to pay Paul and rewarding free riders. And, by subsidizing compliance with the retail 20x2020 targets, funds that MWD collects from some of its member agencies will be benefitting (subsidizing) compliance of other member agencies while providing no commensurate benefit to the "donor" agencies, because those donor agencies do not receive "credit" toward their own 20x2020 compliance goals for spending money (via the MWD subsidies) in other retailers' service areas.

These donor agencies must additionally spend their own rate money to meet their own compliance requirement.

As noted earlier, we believe that measurement and verification are essential to any water use efficiency program, and is in fact, required for compliance. We would note that the data MWD uses to support the conservation section of the IRP is, except for the current demographic data from SCAG and SANDAG, outdated (Attachment A.1, Attachment C-2) (1997). One of the recommendations in the 1997 report was that MWD expand the coverage of its conservation data base to include the many MWD member agencies with respect to which conservation data was not available. (See IRP Attachment A-1 at Attachment C-40)

We believe there is an important role for MWD in water conservation but that its programs must change in order to address the concerns described above. The draft IRP fails to address these important considerations.

COMMITMENT TO THE DELTA

Many agencies and stakeholders are reading the draft IRP recommendation to "immediately" and "aggressively" implement 500,000 acre-feet of Buffer Supply as a signal that MWD is abandoning, or does not believe that it will be successful in fixing the Delta. This comes as a big surprise to our community, which worked tirelessly on the 2009 water bill package and water bond. We do not support changing course and believe that we must diligently pursue and protect our investment in the Delta and State Water Project. The Delta Community is also counting on our continued support. It is our understanding from the information provided by MWD that the Core Resources Strategy includes both a Delta Fix and continuation of existing Colorado River programs contemplated by the Quantification Settlement Agreement. We believe this is the correct approach and consistent with MWD's core mission.

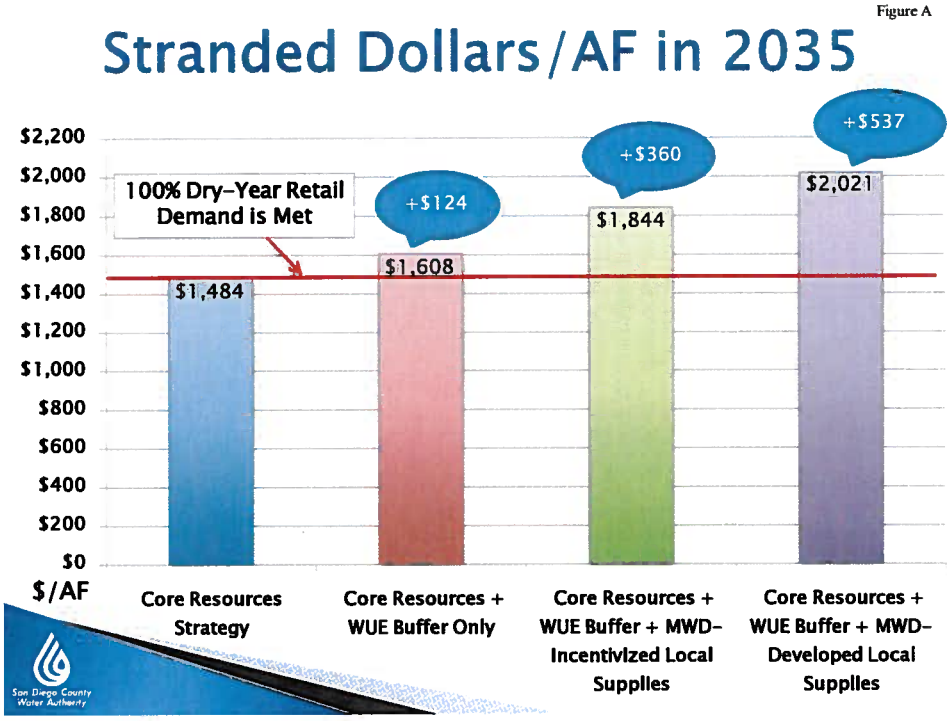
This having been stated, the Water Authority is open to having a candid discussion with MWD, the Delta Community and all interested parties about the nature and extent of the Delta "Fix," if MWD has grown skeptical of the prospects for success in the Delta. In the meantime, and unless and until a *conscious decision* is made – with the benefit of analysis and input from all affected parties – we believe the call for a Buffer Supply sends the wrong message vis-à-vis MWD's intentions in the Delta – and an expensive message at that.

STRANDED COSTS

Since the drought in the early 1990's, MWD's water management strategy has been to invest in storage to take advantage of the hydrologic cycles to best utilize low-cost, available water. Today, this investment, which stands in excess of 5 million acre-feet of storage capacity, has served the region well during the current supply challenges. But, rather than continuing this management strategy to optimize the historic investment in the State's water supply infrastructure and MWD's own low-cost imported water, the draft IRP proposes to shift course in favor of MWD developing local water supplies at a high cost to its ratepayers.

The development of the Buffer Supplies would lead to a similar outcome. If these supplies are not needed – and the draft indicates that demands for the Buffer Supplies will not exist – then the costs to develop them are truly in excess of need and stranded and, therefore, will be stranded costs. A graphic illustration of the stranded costs is shown below in Figure A.

Figure A



It is important that MWD integrate its planning with those of its member agencies so that it does not find itself with stranded investments and future unexpected rate increases due to poor planning.

WHY ABANDON HISTORIC INVESTMENTS AND LOW COST WATER?

Staff's rate analysis released in mid-August sheds light on the following facts: the immediate implementation of Buffer Supply, whether limited to regional consistency Water Use Efficiency of 200,000 acre-feet or the entire 500,000 acre-feet inclusive of local projects would result in abandonment of like amounts of lower-cost imported water, even after it has obligated its share of the Delta Fix improvements. Case in point, in 2035, with Buffer Supply inclusive of Water Use Efficiency only, MWD's own rate analysis showed it would forgo a like amount of imported water due to reduction in sales. The situation worsens if MWD implements the entire 500,000 acre-feet of Buffer Supply, under both MWD-Incentivized and MWD-Developed Buffer Supply scenarios, 500,000 acre-feet of imported water is forgone. Why would MWD spend billions of dollars to develop new supplies and, at the same time, plan to forego use of those supplies?

RESPECT FOR LOCAL AUTONOMY

The key question addressed in the draft IRP focuses on the "role" of MWD. But, with due respect, we believe it's the wrong question. The focus should not be on MWD's "role," but on how the most reliable, cost-effective water supply can be provided to water ratepayers, being

mindful that not every retail water supplier or even every "region" within the vast MWD service territory will answer that question the same way. MWD's "top-down, all-in" planning model in which it will assume responsibility over local water supply development fails to take into account the many cities, local agencies and groundwater managers who grapple with local water supply development issues every day. It is an open question what role these agencies and water suppliers would like MWD to play, but it is certainly important to ask. Historically, the answer to that question would be easy: they want funding to help support local water supply development. We believe that there *is* a role MWD can play in helping to support local projects including funding mechanisms for local supply development. But the rules must be firm and fair, laid out in advance, and equitable to all parties.

DEFINITION OF REGION

Given the dramatic shift in the draft IRP from imported water supplier to local supply developer, MWD should take a step back and ask itself, its member agencies and, critically – the hundreds of cities, counties, water suppliers, groundwater managers and other local districts – how they define their "region" for purposes of local water supply development. MWD has been Southern California's principal "regional" *imported* water supplier. That does not mean that it will be efficient or even logical for MWD to become Southern California's "regional" *local* water supplier. The State, for example, recognizes nine separate IRWM planning groups that are wholly or partially within the MWD service territory. What makes sense for "regional" local water supply development needs to be discussed between and among all interested parties, not just MWD and its member agencies, and be defined in a manner that is practical, workable and equitable to all parties. It is likely that not all local and regional agencies desire to be under the planning umbrella of MWD and its member agencies – whose member agencies often have goals, priorities and objectives that are different than their own.

OUTDATED RELIABILITY GOAL

By declaring allegiance to the 1952 Laguna Declaration, the draft IRP misses a critical opportunity to signal that it is no longer "business as usual" in Southern California or at MWD. Indeed, where and how to establish the reliability goal was not even discussed as part of the IRP process. In today's water-scarce, high-rate environment, our customers want a choice about the level of "regional" reliability they want to pay for.

But the draft IRP goes even further, it advocates a reliability goal of developing core supplies to meet full-service dry year demands at the retail level under all foreseeable hydrologic conditions, *plus* developing a Buffer Supply of 10% of retail demand, *plus* completing project planning for an array of additional projects based on undefined "uncertainty" (the Foundational Actions). This "Laguna Declaration-*Plus*" approach is excessive, impractical and fiscally imprudent. It also flies in the face of California's changed circumstances and Southern California's conservation ethic.

Before staff recommends the highly aggressive supply development outlined in the draft IRP, it should communicate with each of its member agencies to determine the extent to which those

agencies intend to rely upon MWD to meet their future supplemental water supply needs. As aptly noted in the 1994 Blue Ribbon Task Force Report,

> "[It was troubling] to learn, for example, that some of the member agencies most strongly supporting big-ticket projects...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 customers." -- BRTF Report at page 23.

Just as in the past, it is clear that some of the MWD member agencies most strongly supporting the draft IRP are doing so precisely because they believe that it will allow them to become <u>less dependent upon MWD</u>.

NEED TO INTEGRATE MEMBER AGENCY AND LOCAL PLANNING DATA

The draft IRP identifies the need for only 16,000 acre-feet of local projects to achieve the Core Resources Strategy target in 2015 and only 46,000 acre-feet by 2025 and through the end of the planning horizon (2035). According to the draft IRP, this will result in 100% supply reliability under all hydrologic conditions to meet dry-year demand. It is important to note that in reaching the 100% reliability assessment, the plan has taken into account regulatory and environmental constraints on supplies from the Bay-Delta in the years before mid- and long-term Delta improvements are completed.

Based upon review of the limited data included in Appendix A.5 of draft IRP, it appears that as much as 750,000 acre-feet of local water supply is already being planned by MWD member agencies. It is unclear whether this list includes all supply projects that are being planned by cities, groundwater managers, replenishment districts, utilities and other agencies and water suppliers throughout Southern California. Given that the draft identifies only 46,000 acre-feet of local projects is needed to achieve Core Resources strategy's 100% reliability goal, the draft IRP fails to grapple with the reality that MWD sales will be <u>reduced, not increased</u> in the future. If properly coordinated, this trend can be a positive outcome for MWD and all of Southern California. But MWD threatens to disrupt the positive economic impacts of this shift by proposing to over-invest in new water supplies in an ill-fated and illusory attempt to increase its own sales. Failure to coordinate with the many cities, water districts, and utilities beyond MWD member agencies places all Southern California water ratepayers at risk.

The draft IRP also does not provide projected supplies under average- and wet-year hydrologic conditions and their frequencies of occurrence. The draft shows only how MWD's storage would fare under "average" conditions. Figures 4-5 and 4-6 reflect very healthy storage conditions for MWD, but lack data for member agencies to assess how their surface reservoir or groundwater basins could be augmented for dry year use.

In summary, although the IRP by definition is intended to be an *integrated* plan that takes member agency and retail supply plans into account as part of MWD's regional planning, the

IRP draft fails to do so. This presents grave risk to MWD and Southern California water ratepayers.

Finally, MWD's historic and principal role has been to deliver water to Southern California imported from the Colorado River and State Water Project. The subsidy programs were originally created to "encourage" conservation and development of local water supplies that were otherwise not cost-effective, and, in order to "send the right message" to Northern California where it was seeking to maintain its State Water Project entitlement. The rationale was that by supporting these local water supply investments, the costs of securing additional imported water supplies and/or infrastructure were "avoided," and thus the payment of MWD subsidies benefited the region as a whole. MWD should take the time now as part of the IRP planning process to consider the appropriate role of subsidies generally, and including whether subsidies are encouraging or impeding desired outcomes.

FAILURE TO IDENTIFY KEY ISSUES TO MAXIMIZE SURFACE STORAGE, GROUNDWATER STORAGE AND CONJUNCTIVE USE

The draft IRP says that Metropolitan has "gradually shifted from being exclusively a supplier of imported water to collaborating with its member agencies on regional water supply planning issues." This statement does not capture the momentous change that is being recommended for adoption in the draft 2010 IRP, which will place MWD in control of planning, outreach, all state and federal funding and decision-making about local project development. While the draft promises that MWD will "collaborate" with agencies outside of their own member agencies, it appears that it has not collaborated with them in proposing this new role for MWD in the first place. Willingness to allow MWD to become the regional master facilities planner may also vary by region.

MWD's principal, historic role has been as a supplemental, imported wholesale water supplier to its member agencies. While "collaboration" with its member agencies is indeed important, MWD is announcing in the draft IRP a substantially different and enhanced role for itself in the future, including "master planning" for significant local water supply resources over which it has no legal jurisdiction or expertise. The draft IRP does not so much represent a "gradual shift" as a takeover strategy for local water supply development in which MWD will be in charge of local water supply development through its regional master planning process. For example, MWD is declaring that it will be in charge of "master planning" for the following activities:

1. Recycled water development, including creation of a regional finance committee that will determine how all state and federal funding dollars are best spent (Table 5-5);
2. Preparation of salt management plans and groundwater basin management plans (Table 5-7);
3. Seawater desalination "integration" (Table 5-10) and funding mechanisms (Table 5-13); and,
4. Stormwater capture, including regional master planning, implementation of pilot projects and development of subsidy programs (Table 5-19).

MWD's newly announced role as "master planner" for all Southern California local water supply development goes far beyond the function of "collaboration" described above. Given that it has little expertise in groundwater and developing local projects, staffing and budget increases will undoubtedly be on the horizon. These efforts will duplicate those of the many local water suppliers, replenishment districts and groundwater managers who are already engaged at the local level.

In lieu of these proposed changes, MWD should follow the same, more cautious guidelines it suggests for graywater (see page 5-36), namely,

1. Do not establish subsidies to pay for graywater;
2. Focus instead on reviewing and suggesting standards and pursuing changes to legislation and regulations to support graywater development;
3. Work with local entities to create model guidelines for permitting processes; and,
4. Assist with public information efforts as requested and appropriate.

Finally, the draft IRP fails to address the most fundamental questions that must be addressed by MWD at the wholesale level, including: 1) how available imported water supplies will be managed; and 2) what policies are needed to assure fair access to facilities in order to move water stored in groundwater basins in and out of, and within the MWD distribution system.

THE PROBLEM WITH WATER INSURANCE, AKA "BUFFER SUPPLY"

The draft IRP recommends implementation of the Buffer Supply as an insurance policy against uncertainties, but does not provide a quantitative analysis or risk assessment to show how the 500,000 acre-feet of supply development was derived. For this reason, the Buffer Supply is purely speculative.

The Buffer Supply is also financially unsustainable under the current rate structure, since agencies would only pay for the "insurance" when they file a "claim" for the water. The cost of maintaining a large "standby" supply will be extraordinarily expensive, force MWD rates to increase exponentially, and, drive water purchasers away from MWD in search of lower cost supplies that they can control. Here again, the 1994 Blue Ribbon Task Force had it right:

> "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." -- BRTF Report at page 9.

While the draft IRP itself is silent on the cost of the Buffer Supply, MWD's mid-August rate analysis showed startling costs of the Buffer Supply, in terms of sky-high water rates, stranded water supply and stranded costs. The two charts included with these comments were developed based upon this mid-August rate analysis.

Furthermore, the draft IRP appears to ignore the fact that MWD already has a substantial "Buffer" in which it has invested, namely, MWD's vast storage program. MWD has 5 million acre-feet of storage, which the draft IRP indicates will be full on average. The draft IRP also says that if the Core Resources Programs are implemented, the region could have an excess of 1 million acre-feet of water during dry years, when storage and transfers are factored in. If the 500,000 acre-feet Buffer Supply is implemented, *without* MWD taking any water from its storage, the region will have more water than required to meet demands including filling all available storage. The bottom line is that the draft IRP fails to factor in that the very purpose of the existing storage is to provide the same dry year assurance that is proposed to be filled by the new Buffer Supply.

"ADAPTIVE MANAGEMENT" INADEQUATELY DEFINED

Although the draft IRP says that MWD will employ an "adaptive management" strategy, the draft also concludes that an aggressive approach to immediately implement the Buffer Supply is required. In general, it is not possible to discern from the draft IRP what the timing or "triggers" are for any of the "adaptive" actions. The draft IRP is also inconsistent with statements made by MWD staff at the August 10 San Diego Stakeholders Forum with regard to timing of adaptive management actions described in the draft IRP.

At its own August 20 member agency managers' meeting, MWD staff stated that it plans to only recommend immediate implementation of the regional consistency Water Use Efficiency Buffer, and leave the implementation of the Local Resources Buffer to occur only when certain trigger events take place, such as failure to obtain the environmental documentation for a Delta conveyance facility by a date-certain (yet to be specified). This is a very different position than the draft's aggressive approach to implement local projects as delineated within the draft IRP as follows:

> Page 4-20, "Implementing a Supply Buffer," states, in part: "...a 'planning' Buffer was introduced during the 2004 Update. The 2010 IRP Update proposes to expand the concept of a planning Buffer and <u>create an actual hedge</u> against demand uncertainty, by <u>implementing</u> a supply Buffer equivalent to 10 percent of total retail demand. Metropolitan will collaborate with the member agencies to <u>implement</u> this Buffer through complying with the 20X2020 legislation, and by <u>implementing aggressive</u> adaptive actions to meet any remaining portion of the 10 percent Buffer." (Emphasis added.)
>
> On page ES-8, the draft states: "Maximizing regional benefits through economies of scale and minimizing the cost of redundancy is important to adaptability. The 2010 IRP Update <u>will</u> hedge against demand, supply and environmental uncertainties by <u>implementing</u> a supply Buffer equivalent to 10 percent of total retail demand. This Buffer <u>will be implemented</u> through meeting 20X2020 water use efficiency goals, and by <u>implementing aggressive adaptive actions</u> to meet the remaining portion of the 10 percent Buffer through local supplies and transfers. This approach is consistent with maintaining reliable baseline supplies and advancing local and regional solutions." (Emphasis added.)

> In its outreach materials used at the IRP Public Forums, MWD has an executive summary, page ES-10, that states the Buffer Supply will be "...developed through collaboration with the member agencies on aggressive actions." And, on Figure ES-4, Component 2 box reads "aggressive adaptive actions for the remainder." (Emphasis added.)

It is impossible to reconcile the oral comments made by MWD staff at the August 10 Stakeholder Forum and the August 20 MWD Member Agency Managers meeting with the conflicting verbiage in the draft IRP document.

It is also completely unclear what "adaptive management" means or how it will be employed by the MWD staff once the IRP is adopted by the board. Substantially more detailed planning and transparency is required before board adoption so that the member agencies can better understand what is intended by the draft IRP.

INACCURATE AND INCOMPLETE DATA

The Core Resources Strategy is the heart of MWD's current water supply planning. It is essential that the draft IRP provide a full description of the components of the Core Resources Strategy. And yet, it is not possible to discern the details of the Core Resources Strategy due to the fact that there is inconsistent data presented throughout Sections 4 and 6 of the draft IRP. These are the key sections of the report that present analyses of the available water supplies and need to develop additional supplies.

To ensure a sustainable resource plan that clearly outlines a path for long-term reliability, it is fundamental that the draft IRP start with a more comprehensive evaluation of the Core Resource Strategy. The Core Resource Strategy serves as the foundation of the plan. The analysis should include an identification of what actions can be taken to strengthen the core strategy in order to maximize investments already made in imported supplies. The evaluation should include an assessment that clearly identifies the risks associated with implementation of the core strategy and takes adaptive measures to mitigate those risks. This assessment would provide a linkage between the Core Resource Strategy and the timing and type of adaptive management strategies recommended. Transparency in the process is critical to providing the member agencies the data and information needed to plan accordingly in their UWMP and resource plans.

In addition to the internal inconsistencies, the data included in the draft IRP is also inconsistent with data included in MWD's recently released draft Regional Urban Water Management Plan (RUWMP). The Water Authority suggests that MWD staff conduct a workshop with the member agency managers to work through this detail so that MWD's Core Resources Strategy can be presented in a manner that may be better understood and inconsistencies with MWD's RUWMP can be reconciled.

To cite just a few examples, seawater desalination is listed as existing production on Table 4-6 but as a yet-to-be-developed Core Resource on Table 4-8. There is no indication how the groundwater, local surface water and Los Angeles Aqueduct (LAA) supplies listed in Table 4-7 were projected. And, it is unclear why there is an increase in groundwater supplies during this

planning horizon, but a decrease in surface water. The data for LAA also differs between the IRP and RUWMP. These and other inconsistencies and lack of foundational data are not "details" to be "worked out later" – rather, this is foundational information required in order to meaningfully assess MWD's current supplies and the need to develop additional supplies.

Beyond the internal inconsistencies in the draft IRP, there is also insufficient information provided on the plans of cities, groundwater agencies, replenishment districts, utilities and water suppliers throughout the Southland to implement conservation and other local water supply programs that will substantially reduce the amount of water purchases from MWD in the future. While the draft notes that there are approximately 250 retail agencies that supply water to the public, the draft IRP analysis has failed to account for the plans and timing of plans that many of these 250 retail agencies have to both conserve water and develop local resources. Although Appendix A.5 includes a list of member agency area projects, it does not provide analysis to show how these projects will reduce the demand for MWD supplies. It also does unclear whether it includes projects of the many agencies, sub-agencies and utilities who presently buy water from MWD member agencies. MWD must work with its member agencies to develop an accurate and agreed upon list of projects as well as project timing, and eliminate inconsistencies before it finalizes the draft IRP.

Moreover, MWD's methodology limits its accounting of local supplies to existing, under construction and "committed" projects (a term not defined in the draft IRP). All other planned local projects are included as part of MWD's own "regional" target, with the explanation that, "... [t]his recognizes the uncertainty in local supplies and avoids over and under allocating local supply targets to individual agencies" (see Appendix A.1-22, "Projected Active Conservation: A New Approach). This approach appears grounded in MWD's past experience and the notion that local water suppliers cannot be relied upon to develop local supplies and, therefore, MWD must step in and take over responsibility for local supply development. This assumption fails to take into account the substantially changed circumstances and that many local water supply projects that were once uncompetitive with the price of imported water are now cost-effective – without any subsidies from MWD – when compared to even the conservatively projected cost of MWD water. There are also better mechanisms to hold local water suppliers accountable to the region for completion of projects than the theoretical no-cost or low-cost water supply Buffer "insurance" recommended in the draft IRP.

The realistic regional demand "gap" cannot reasonably be estimated without taking into account the existing and planned actions of MWD's member agencies and other local water suppliers. The draft IRP notes that Metropolitan has historically provided between 45 and 60 percent of the municipal, industrial, and agricultural water used within its service area. However, enhanced conservation and development of local water supplies will result in a dramatic reduction in water demand on MWD. Implementing any of the Buffer Supply strategies in the draft IRP will lead to unavoidably higher rates and inversely declining sales.

PROCESS CONCERNS

While there have been a large number of meetings and IRP-related "processes," the process overall has been both "top down" and "disintegrated," with no meaningful opportunity for non-MWD member agency participants to shape the outcome. This shortcoming is all the more important given the draft IRP proposes that MWD become responsible for, or compete with many local projects that are currently within the jurisdiction of cities, local agencies and groundwater managers. The 1994 Blue Ribbon Task Force made similar observations about the then-pending IRP process:

> "Although both the IRP and rate structure efforts largely 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." -- Blue Ribbon Task Force Report (BRTF Report) at page 8.

> "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." -- BRTF Report at page 12.

> "Despite a heavy meeting schedule, and numerous specialized committees and subcommittees, the Board often seems to be presented with limited options and choices for final approval largely defined and developed by MWD staff, rather than conduct an independent inquiry of relevant matters." -- BRTF Report at page 74.

These observations are as accurate regarding the current draft IRP and IRP process as they were more than 15 years ago. The 2010 draft IRP has been available for public review only recently, and although voluminous, contains limited information. The revised draft IRP will apparently not be available until later in September, with board adoption scheduled for October. This schedule and process does not allow for meaningful distribution or review of the draft IRP by those who are impacted through the adoption of the IRP. MWD staff has been portraying the draft IRP as implementation of the will of the people, rather than as a recommendation of MWD staff. But, of the almost 19 million people who live and work in Southern California, less than 350 people attended the four stakeholder workshops combined – and, many of those participants were MWD and member agency staff and consultants. Moreover, the stakeholders were being asked to comment on a draft report in which fundamental questions remain to be answered.

Given that MWD is proposing to change its historic role as imported water supplier – which is the principal responsibility most local agencies now associate with MWD – it is vitally important that sufficient time be allowed for distribution to city councils, county board of supervisors, groundwater managers, replenishment districts, water districts, utilities, and other local entities which will bear the expense of, or otherwise be impacted by MWD's new role. MWD and its member agencies should not simply assume that all agencies and stakeholders will welcome this new role for MWD or the associated rate increases that will be necessary to implement this course of action.

RECOMMENDATIONS

MWD uses the IRP as a foundation for its RUWMP. Thus, the draft IRP should reflect the clear professional recommendation of MWD staff. Is that the case? If so, we recommend you say so when the revised draft IRP is released. As it stands in the draft IRP, this is unclear.

At a minimum, we recommend that MWD provide a full 60-day review period between the release of a revised draft IRP, including responses to all comments and questions, and the first MWD board meeting to consider the revised draft. We also recommend at least two public meetings of the board to consider and deliberate the revised draft IRP. This time frame would still allow adoption of the IRP in advance of the RUWMP. Although the update process stated more than a year ago, the recommendations were made available for the first time in July 2010 when draft report was posted online. We were quite surprised with the recommended strategy, especially since the draft's own data indicates the excessiveness of such a recommendation. The draft recommends an adaptive strategy that included three components: Core Resources Strategy, Buffer Implementation, and Foundational Actions.

The draft IRP clearly indicated that the implementation of the Core Resources Strategy would meet projected dry-year demands under all foreseeable hydrologic conditions, with MWD's 5 million acre-feet of average storage capacity above 60 percentile and probability of dry-year shortage diminishing to zero past 2015 (with only than less than 1 percent shortage in 2015). Yet, it recommends moving forward with all three components concurrently, including aggressively pursuing Buffer Supply implementation (in contrast to 2004 IRP's planning buffer) and at the same time developing large-scale projects so they are "ready to proceed" under Foundational Actions.

The forthcoming revised draft IRP must integrate member agency plans and projects into the discussion, and before implementation of projects that exceed demand, member agencies' commitment to pay for these supplies must be obtained and proper choice and structure be set in place to ensure MWD does not strand water nor investments under the new supply strategy.

ATTACHMENT 3 – QUESTIONS POSED AT SAN DIEGO IRP FORUM

RELIABILITY GOALS

- Doesn't the IRP's reliance on the almost 60 year old Laguna Declaration – drafted at a time when Southern California was almost completely dependent on imported water – send the wrong message in today's limited resource and escalating cost environment? Is that a smart message in the water bond campaign?
- Why didn't MWD reconsider the central question of the where the regional reliability goal should be set?
- Why should everyone have to pay for the same reliability standard if they want to conserve more and pay less?
- How has MWD accounted for the dampening effect higher prices will have on water demand?

SUPPLY AND PLANNING BUFFER

- Has MWD done a survey of each of its member agencies and other local agencies and utilities to determine what projects they are developing now or plan to develop in the near future? Don't you need this kind of information in order to determine what supply "gap" exists?
- Will MWD staff agree to collect this information about local projects development and make it available before asking the board to adopt this IRP?
- What is the rationale for an MWD Buffer Supply equal to 10% of retail demand? What is that number based on?
- What is MWD's assumption in the IRP about who will pay for the core and Buffer supplies? Is there a breakdown of this by region or project? Isn't this information necessary to define even broad parameters of a real plan?
- Is staff recommending the implementation of both core and Buffer supplies because it does not believe it will be successful in the Delta Fix? If not, why does this draft recommend moving forward now with implementation of both supplies?
- Can you be more specific about the risks and uncertainties you believe justify the expenditure of current ratepayer dollars? What are the "trigger points" that would warrant increased spending?
- What is the level of commitment to developing the resources identified in the Buffer? And is there a certain date by which those resources will be developed?
- Why are recycled water and seawater desalination identified as part of the Buffer supplies?
- What is the size and composition of the Buffer?
- What is the process by which the region will make the decision to deploy elements of the Buffer? And are there risks associated with each trigger level?

MWD'S ROLE

- Isn't our current water supply allocation the result of challenges to our imported supplies? Since this has been MWD's historical role, shouldn't MWD focus its efforts and regional dollars on securing the Delta Fix and filling the Colorado River Aqueduct?

MEMBER AGENCY'S ROLE

- Does the IRP assume and recognize that the 20x2020 requirement is a retail obligation? Given that, why should MWD subsidize member agencies to meet this local mandate? Isn't this rewarding bad behavior?
- What is the IRP assumption about the project cost that would qualify for a financial "incentive" from MWD?
- Won't MWD by definition be investing in the most expensive sources of supply? [*Comment: If not, why would the local agency need an "incentive"?]*
- How does Met intend to ensure fairness among its member agencies in the collection and redistribution of incentive money for conservation and local projects?

PROJECT ASSUMPTIONS

- What is MWD's assumption on who will implement the 20x2020 mandate?
- What are MWD's planning assumptions for the on-line dates for the member agency projects described in the Appendix?
- What are MWD's assumptions for supply conditions under normal and wet years?
- What assumptions does the report make about how surplus water in any given year will be used? Will it go first to refill MWD's storage? Do you assume that discounted replenishment rates will be available at any time in the future? If so, under what conditions?

COST ANALYSIS

- What are the cost assumptions for core and Buffer Supply projects?
- What is the estimated rate impact as a result of implementing the core strategies? Is this impact based on an assumption the current rate structure remains unchanged?
- What would the implementation of Buffer Supply add to water rates?
- What about the Foundational Actions? How much would those activities add to water rates?
- Will MWD do a new rate structure analysis and cost of service study for IRP programs and projects before adopting the IRP?
- How does MWD ensure its core supply investments would not be stranded?
- Is MWD going to require firm contractual commitments from each of its member agencies to pay for all of this supply development?
- How do preferential rights relate to the availability of Buffer Supply water? Are they enforceable if a member agency claims them?
- Do you have any analysis available to show the "balancing" between resource investment and cost considerations?

TIMING

- IRP sets forth MWD's policy for future supply development and is an especially important document given changed water supply environment. Why the rush to get the report adopted so quickly?
- Are you willing to recommend extending the time for MWD staff to answer our questions before we are required to comment further on the report?

THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Manager

RECEIVED
AUG 30 2010
GENERAL MANAGER

August 25, 2010

Ms. Maureen A. Stapleton
General Manager
San Diego County Water Authority
4677 Overland Avenue
San Diego, CA 92123

Dear Ms. Stapleton:

Notice of Intent to Initiate Process to Consider
Termination of Incentive Agreements with the Water Authority

The agreements listed below between Metropolitan and the San Diego County Water Authority (Water Authority) contain provisions allowing The Metropolitan Water District of Southern California (Metropolitan) to file a 90-day notice of intent to consider terminating agreements should the Water Authority file litigation challenging Metropolitan's rate structure. In June 2010, the Water Authority initiated litigation challenging Metropolitan's water rates and charges for fiscal year 2010/11. Consequently, Metropolitan's Board of Directors at its August 17, 2010, meeting directed staff to initiate the process outlined in the rate structure integrity provisions.

Incentive Program	Existing Agreement	Number
Conservation	Regional Commercial Program	66654
Conservation	Regional Residential Program	78189
Enhanced Conservation	Landscape Auditor Interns	011-2006
Enhanced Conservation	Smart Landscape Grant Program Expansion	024-2007

This letter is the official 90-day notice of Metropolitan's intent to consider termination of the above listed agreements between Metropolitan and the Water Authority.

Within 30 days of receipt of this notice, the Water Authority has the right to request, in writing, mediation of the dispute by a neutral third party with expertise in finance and rate setting. The request for mediation would serve to stay the 90-day notice of intent to terminate, but for no more than 90 days beyond the filing of the notice of request for mediation. If the termination process advances, Metropolitan's Board of Directors will ultimately make the decision on whether to terminate the agreements. Payment of the incentives for this program will continue pending the decision by the Board following the 90-day notice period.

Metropolitan's Board of Directors also directed staff to defer execution of the following three agreements currently pending with the Water Authority, as termination proceedings would begin immediately upon execution:

Incentive Program	**Pending Agreement**	**Number**
Conservation	Agricultural Conservation Program	113401
Innovative Conservation	Flow control valve research project	91694
Seawater Desalination	Carlsbad Seawater Desalination Project	70025

If you have any questions, please contact me at (213) 217-6211 or via email at jkightlinger@mwdh2o.com.

Very truly yours,

Jeffrey Kightlinger
General Manager

WAT:jc
o:\a\s\c\2010\WAT_SDCWA Agreement Termination_Notice v3.doc

cc: Board of Directors
Executive Secretary

San Diego County Water Authority
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May 16, 2011

Thomas DeBacker
Interim Chief Financial Officer
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Dear Mr. DeBacker:

We have reviewed Appendix A of MWD's Draft Official Statement (Draft OS), distributed to members of the Board of Directors on May 6, 2011 for an upcoming bond sale. As you know, the Water Authority's MWD representatives have sent two prior letters regarding Appendix A dated September 22 and December 9, 2010, respectively, copies of which are attached and incorporated by reference. Although MWD made specified changes as described in your response letters dated September 23 and December 13, respectively, we do not believe that MWD has addressed the following concerns.

2010 Integrated Resources Plan (IRP) is Inconsistent with Finance Plan
MWD has stated that the purpose of the IRP is to serve as a long-term planning guideline for resources and capital investments. The 2010 IRP strategy proposes the overdevelopment of water supplies by as much as 500,000 acre-feet (AF) annually. The Draft OS does not reflect the policy or cost implications of such a strategy. Indeed, MWD's Long Range Finance Plan does not "square" with the IRP and neither document describes the significant cost implications of such a business plan.

Water Sales are Overstated and Rate Increases are Understated
The water sales indicated in the Draft OS for 2010/11 are inconsistent with actual water sales, now projected to be 1.44 million acre-feet. Future water sales projections in subsequent years are also overly optimistic and inconsistent with sales trends. MWD does not have the ability to sustain sales in the 2 million AF range continuously without substantial investments and associated rate hikes – which could further depress rather than encourage water sales. Indeed, MWD acknowledged this rate pressure in its board memo last month recommending the sale of discounted water due in part to the budget and other fiscal constraints its member agencies are facing.

Projected rate increases of "one and two percent above the annual rate of inflation (projected at 3.5 percent per year)" is similarly unrealistic taking into account the investments MWD must make to sustain current levels of water supply availability, let alone the ambitious plans described in the IRP. Moreover, while MWD acknowledges that, "no member agency of MWD is obligated to purchase water from MWD," there is insufficient disclosure of the extent to which MWD member agencies are currently pursuing plans to secure water supplies outside of MWD.

Indeed, MWD itself is paying subsidies to its member agencies to purchase less of its water in the future.

Water Wheeling and Exchange Reporting is Misleading
The Draft OS mischaracterizes revenues from transportation of the Water Authority's QSA water as water "sales" revenues. This treatment is misleading and appears to artificially inflate MWD water sales revenues.

Storage Portfolio "Take" Capacity is in Error
The Draft OS states that MWD's in-region conjunctive use program includes more than 115,000 acre-feet of extraction capacity per year. This is inconsistent with MWD's May 2011 WSDM report indicating a 2011 "take" capacity of only 62,000 acre-feet annually – which included 35,000 acre-feet of extraction capacity from the North Las Posas groundwater basin which is no longer accessible to MWD.

Need for Funds; Inadequate Disclosure re: Reserves
Last December, we questioned why MWD is selling bonds given upward water rate and downward water sales trends. We now know that these trends are also having a highly negative impact on MWD financial reserves – a fact that is inadequately described in the Draft OS. But for the one-time revenues from the Calleguas settlement and sale of surplus property, MWD's reserves would be below the board established minimum level. Continuing to issue debt will further exacerbate MWD's dire financial situation and is not sustainable.

We request that the Draft OS be modified to address these issues and ensure MWD provides adequate disclosure to potential investors.

Sincerely,

Fern Steiner
Director

Attachments

cc: MWD Board of Directors
Jeff Kightlinger, General Manager

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April 11, 2011

John V. (Jack) Foley
Chairman
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

Board Agenda Item 8-4: Approve proposed biennial budget for fiscal years 2011/12 and 2012/13 – OPPOSE

REQUEST TO REOPEN 2011/12 BUDGET AND FOR SPECIAL BOARD WORKSHOP TO CONSIDER REVISED 2011/12 BUDGET AND PROVISIONAL 2012/13 BUDGET

Dear Chairman Foley:

We have reviewed Board Memo 8-4 (budget board memo) dated March 30, 2011, and the PowerPoint Presentation for the Finance and Insurance Committee meeting that was posted on the MWD Web site Friday afternoon. We believe new financial information contained in the PowerPoint represents material changes to the information the board has previously been provided. Because of this, it would be premature to adopt any budget at Tuesday's board meeting. We request, and hope that you will agree to defer action on the budget this week and, instead, promptly schedule a Special Board Workshop to give the board an opportunity to reconsider the assumptions included in the 2011/12 and 2012/13 budgets.

New Financial Information
The PowerPoint shows that:

- MWD water sales are trending to be 291,000 acre-feet below budget this year. Not including the Water Authority's QSA supplies (161,000 AF this year), if this trend proves right, MWD's water sales for the year would be 1.475 MAF, the lowest figure in more than two decades.

- From a fiscal standpoint, if the sales trend continues, the budget shortfall this year would be $194 million. MWD plans to cover this revenue shortfall in large part by drawing down its reserves by $126 million. *This is nearly twice the amount included in the budget board memo*, which stated that $64 million would be withdrawn from reserves.

- It appears that this latest forecasted withdrawal of $126 million may cause the Rate Stabilization Fund (RSF) to dip below the board policy minimum level this year. Because not enough cuts are being proposed for 2011/12, the projected budget assumes using RSF to meet the revenue gap. If water sales in the coming budget year track this year, they would be nearly 165,000 acre-feet below the 1.8 MAF sales assumption, leading to an additional revenue shortfall. This revenue gap – combined with the "escrow account" MWD shows reserved against available funds in the RSF – could deplete the RSF fund as soon as next year.

Projected Water Sales

In spite of these clear and alarming trends – *and actual results included in the new financial information* – the proposed budget assumption of 1.8 MAF of water sales for both 2011/12 and 2012/13 poses significant fiscal risks to MWD. Those risks are compounded by assumptions in the budget that *MWD sales will return to 2 MAF in 2013/14 and following years*. Given actual experience over the past three years – and state law requiring retail agencies to achieve 20 percent reductions in per-capita consumption by 2020 – we do not believe these sales projections are prudent assumptions for budgeting purposes. While we recognize that the MWD board will likely lift water supply allocation this week, there is no evidence to suggest that action will result in MWD sales returning to these levels. To the contrary, we believe that MWD water sales in the next fiscal year will more likely track this year since many MWD member agencies – most notably the City of Los Angeles – will be taking advantage of low-cost local water supplies following this favorable water year. These facts should compel the board to use more conservative water sales projections, especially when facing the prospect of depleting the Rate Stabilization Fund.

Insufficient Cost Reductions to Match Lower Sales Base

Overall, staff has not recommended cost reductions for the 2011/12 fiscal year sufficient to match the anticipated lower sales forecasts or actual FY 2010/11 results presented in the new financial information. Because of this, MWD runs the risk of significantly overspending in the coming fiscal year. We have previously communicated to staff a number of suggestions for reduction of CIP expenditures that could be achieved by: delaying or deferring additional projects, including ozone retrofit at Weymouth; using power purchase agreements to achieve solar objectives; and, deferring investment in Hayfield for water supplies that are not needed for the next few years. There are other projects MWD should delete from its budgets entirely, including "system integration" for member agency seawater desalination programs. That project, and other new LRP projects and all member agency subsidies should be suspended until MWD develops a new budget and financial plan to illustrate why it makes sense for MWD to pay its member agencies to buy less water at a time its sales have fallen nearly 300,000 acre-feet below projections.

The specific project deferrals noted above would result in a CIP reduction of at least $115 million, or nearly 20% over the next two-year CIP budget. Undoubtedly, there are other cost-cutting measures MWD could, and should adopt within both the CIP and O&M budgets that would be more consistent with reserve and water sales trends. We want to be clear that the solution to MWD's reduced sales is not to raise water rates – thus adding to the 56% increase in the Tier 1 Treated Rate approved between 2008 and 2012. Rather, the board must take the time now based on the new financial information to review all MWD expenditures with a critical eye, and adopt meaningful reductions that will help MWD stabilize its finances over the next few years and match its spending to a lower and more realistic water sales base.

Deferral of OPEB and PAYGo

We are also concerned that the budget does not address or manage MWD's $450 million liability for other post-employment benefits (OPEB) and that, by failing to do so, is shifting a disproportionate burden to future ratepayers. Similarly, we believe MWD's total CIP should be reduced to the extent necessary to achieve an appropriate level of PAYGo funding. MWD should also budget for the necessary deposits into escrow of increasing amounts annually attributable to MWD's Exchange Agreement with the Water Authority. This amount could total as much as $120 million to $250 million over the next three to five years, yet has not been accounted for, or even discussed during the budget process.

Storage Budget

MWD has failed to meaningfully budget for the costs associated with storing water as part of its water supply reliability program. The costs of storing water in good years are necessary in order to achieve this core strategy of MWD's water resource plans. If MWD is not going to budget for these costs – or actually store as much water in its storage accounts as is available in good years like this – then MWD's entire storage and resource program strategies must be reconsidered. MWD staff has consistently stated that constraints in the Delta mean MWD can count on wet-year supplies in only three of every 10 years - this is one of the three years. We are concerned that MWD may not be maximizing all opportunities to fill its storage accounts this year, as it appears it has not budgeted sufficient funds to do so in the past or in the proposed budgets.

Conclusion

Overall, the budgets as proposed by staff evidence a trend toward deferring a disproportionate share of expenses to the future – solely on the basis of optimistic sales forecasts – rather than grappling with the very real, difficult budget issues confronting MWD now. Temporary deferral of expenses to future years to mitigate rate shock as a result of unanticipated events is one thing, but the prolonged and continued deferrals to the future is not prudent nor sustainable. Similarly, the continued dipping into reserves to meet revenue gaps that could be minimized by cutting expenditures is equally imprudent. This practice could result in depletion of the Rate Stabilization Fund, breach of revenue bond debt service coverage requirements and/or accelerated or mid-year rate hikes as soon as 2012. These are neither desirable, nor acceptable outcomes when the board has other, more responsible options available to it to manage our water supplies – and finances – in an era of declining sales. We recommend that the board reopen the adopted 2011/12 budget to better match expenditures to projected sales and revenues.

In closing, we would note that the MWD budget reflects the ongoing challenges of having very high fixed costs and minimal fixed revenues. The time for the board to address and correct this and the other fundamental policy issues outlined in this letter is long overdue.

Sincerely,

Jim Bowersox	Lynne Heidel	Keith Lewinger	Fern Steiner
Director	Director	Director	Director

Cc: Jeff Kightlinger, General Manager

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August 15, 2011

Jack Foley, Chairman
Metropolitan Water District of Southern California
PO Box 54153
Los Angeles, CA 90054-0153

Re: Board Memo 8-7 – Adopt the Long-Term Conservation Plan and revised policy principles on water conservation – OPPOSE

Dear Chairman Foley:

We write to express our opposition to Board Memo 8-7, Adopt the Long-Term Conservation Plan (LTCP) and revised policy principles on water conservation. During the planning process, MWD stated that its objective was to "focus on its strengths and opportunities as a large regional wholesale water agency." The LTCP fails to achieve this core objective. Instead, it muddles the roles and responsibilities of MWD with retail water suppliers. By doing so, the LTCP is much more likely to impede rather than promote expanded water conservation in Southern California.

The Water Authority strongly supports expanding water conservation programs beyond current legal requirements. However, as a regional water supplier, MWD must target water use efficiency *beyond* what retail water suppliers are already mandated to do under the Water Conservation Act of 2009. MWD should not use regional ratepayer dollars to fund any 20x2020 retail compliance. MWD must also adjust its other water supply development projects to account for increased water conservation in order to both provide regional benefit and avoid stranded investments. The LTCP fails entirely to present a plan to meet these requirements. The LTCP makes no distinction between zero-cost conservation measures and investments in very expensive local recycled water projects of selected MWD member agencies. The Water Authority opposes any investment of regional ratepayer dollars in local conservation and recycled water projects of individual member agencies absent a showing of regional benefit.

The Water Authority has provided detailed comments and analyses on past drafts of the LTCP and August 2010 Board Memo 9-1, MWD Water Conservation Program (copies attached), all of which are incorporated herein by this reference. We are disappointed that none of the issues we have raised has been responded to during the long editing process MWD has conducted or in Board Memo 8-7. Despite repeated requests, no assessment has been conducted to evaluate what conservation programs have worked in the past and those that have not. Although the proposed LTCP recognizes only a small percentage of water savings are from devices, the only recommended conservation programs outlined in the LTCP are based on payment of subsidies for devices. As a regional agency, MWD has the ability to influence laws, ordinances and regulations to encourage wise water use, and yet the LTCP has virtually no discussion on what role MWD will play as a regional water supplier. Indeed, the LTCP does not provide *any details or*

strategies of how MWD plans to achieve water savings above those that are already required by state law. Due to these deficiencies, the MWD board is essentially being asked to vote in favor of a "blank check" in the name of water conservation. MWD staff has a responsibility to address the issues on the merits and the MWD board should have an opportunity to deliberate the issues based on staff analysis – and make decisions that are in the best interest of MWD's regional water ratepayers.

It is premature to delegate authority to a Program Advisory Committee consisting of member agency managers to develop research and program priorities. We renew our request for a board workshop to review the many policy and legal issues that are not addressed in the LTCP, including an evaluation of MWD funding of conservation and local water supply development programs after passage of Proposition 26. We would ask our staff to work with MWD staff and other member agencies to craft the board workshop agenda. If the MWD board fails to act now, we lose a critical opportunity to show the Southern California and the rest of the state that MWD is serious about water conservation.

Sincerely,

Fern Steiner, on behalf of the Water Authority's MWD Delegation

cc: MWD Board of Directors
SDCWA Board of Directors

Attachments:
1. August 16, 2010 Letter to Chairman Brick re: Board Memo 9-1
2. September 10, 2010 Comment Letter on MWD 2010 IRP
3. November 29, 2010 Comment Letter on Draft LTCP
4. July 20, 2011 Letter, Comments on LTCP Working Draft Version 11

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August 16, 2010

Timothy Brick
Metropolitan Water District of Southern California
PO Box 54153
Los Angeles, CA 90054-0153

Re: August 2010 Board Memo 9-1, MWD Water Conservation Program

Dear Tim:

Board Memo 9-1 addresses what is described as an "opt in/opt out" approach for MWD's water conservation program. The memo concludes that accounting for conservation at the individual member agency level would be too difficult and would threaten the efficacy of MWD's Integrated Resources Plan, Water Supply Allocation Plan and other programs. Although we strongly support increased conservation, we respectfully disagree with the analysis and conclusions stated in the Board Memo. The MWD board must consider changed circumstances and legal requirements to ensure that any future regional program integrates with local programs, and, avoids creating conservation disincentives through the pricing structure, water supply allocation plan, or otherwise.

The Water Conservation Act of 2009 (the Conservation Act) established new methodologies, water use targets and reporting requirements. The Act's requirements apply to urban ***retail water suppliers***. Although MWD and its wholesale member agencies have a supporting role, primary responsibility falls to each retail agency within MWD's service territory. The board memo does not address these requirements or explain how a regional program would integrate with or support these retail conservation programs.

Although the Board Memo appears to *assume* a regional compliance approach, the Conservation Act provides that urban retail water suppliers must achieve and report compliance on an individual basis unless certain prerequisites for regional compliance and reporting are met. Among other things, regional compliance requires the written consent of each retail agency.

As a wholesale water provider, MWD's role in conservation must be carefully evaluated in light of these new legal requirements. Since it is unlikely that all retail water suppliers within MWD's service territory will elect to report as part of MWD's regional water management group, MWD must account for that as the regional program is being developed. MWD must carefully assess how a regional program can fairly integrate with the individual programs its member agencies choose to implement to ensure that each retail agency and group of ratepayers is carrying its lawful and equitable share of the cost.

Turning to some of the other key issues, we believe that changes in MWD's water shortage allocation plan are necessary to encourage further conservation. The City of Long Beach has presented a number of ideas and approaches to address this concern. We also believe that MWD's wholesale price structure discourages conservation by disguising the true cost of alternative water supplies. By continuing to offer regional subsidies to retail agencies to meet conservation targets that are already required, MWD is actually discouraging water conservation. This element of the current plan creates free riders, and, fails to ensure that each member agency pays its fair share or that all MWD water ratepayers are treated fairly.

As noted earlier, the board memo also states that water conservation at the member agency level would be difficult to quantify and measure and could be labor intensive in verification; however, we believe that measurement and verification are essential to any water use efficiency program, and is in fact, required for compliance.

Finally, the board memo states that consideration of different approaches to conservation would require MWD to reconsider its message under the Laguna Declaration. The Laguna Declaration has been included in the IRP draft as a statement that MWD will provide all of the water anyone needs at any time under any hydrologic condition. But we believe the Laguna Declaration is not a reason to refuse to consider changes in MWD's conservation program. To the contrary, we believe that MWD *should* reconsider whether the Laguna Declaration properly reflects California law and public policy, or, Southern California's conservation ethic. Our ratepayers have said that they want a choice whether to conserve more in lieu of paying for 100% water supply reliability 100% of the time. It is imperative that MWD work with its member agencies to ensure that we can offer them that choice.

We would like to reiterate that the Water Authority strongly supports increased conservation. We believe there is an important role for MWD but that MWD's water conservation program must change in order to address the concerns described in this letter.

Sincerely,

Fern Steiner on behalf of the Water Authority's MWD Delegation

cc: MWD Board of Directors
SDCWA Board of Directors

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September 10, 2010

Jeffrey Kightlinger
General Manager
Metropolitan Water District of Southern California
PO Box 54153
Los Angeles, CA 90054-0153

Re: 2010 Integrated Resources Plan Update

Dear Jeff:

Water Authority staff has completed its review of the draft 2010 Integrated Resources Plan Update (draft IRP). We plan a broader outreach effort to our region's cities, stakeholders and communities once we have complete information and a revised draft IRP document. Given that the current draft IRP has only been available since July, and since the revised draft won't be available until sometime later in September, we reiterate our request that the October timeline for adoption of the IRP be extended to allow for broader distribution of the revised draft IRP here and in other parts of the MWD service territory. This outreach should then be followed by additional public meetings of MWD's board so that the merits of the revised draft IRP can be fully deliberated in a transparent setting after MWD responds to all the current comments and questions.

Changed Circumstances

The water supply and cost environment have fundamentally changed since the IRP was last updated in 2004. Twenty percent water conservation is now legally required at the retail level by 2020. Replenishment deliveries by MWD have been interrupted indefinitely. Severe cutbacks of water supplies from the Bay-Delta are now a way of life for the foreseeable future. We must plan for impacts of climate change. As a result of these and other changed circumstances – and taking into account the reasonably anticipated cost of a Delta Fix – conservation and local projects that once warranted subsidies have become cost effective compared to MWD's current and projected water rates. For this reason, many of the more than 250 retail water agencies and cities in the MWD service territory are now in the process of expanding conservation programs and developing local water supply projects.

Although the draft IRP refers generally to some of these changed circumstances, it does not recommend any changes in the basic MWD business model to address them. The draft IRP plan essentially assumes the same base resource mix and adds a massive, undefined "Buffer Supply" to mitigate undefined and unquantified uncertainties. Instead of asking how it may best *coordinate, encourage and integrate* with planned conservation and local water supply development that is already under way throughout the service territory, MWD proposes to embark on a massive spending program.

Stranded Costs and Stranded Historic Imported and Low Cost Water

MWD's IRP strategy will drive MWD's rates up drastically and lead to lower water sales by MWD as local agencies develop lower-cost supply alternatives. With the Buffer Supply strategy in the draft IRP, MWD is setting itself up for a perfect storm of skyrocketing water rates and plummeting water sales. This course of action amounts to a fiscal death-spiral for MWD and is financially unsustainable.

While it is not possible to determine from the draft IRP precisely what the current core supplies are or how the proposed Buffer Supply will be developed as MWD projects and member agency projects (or any iteration thereof), one thing is very clear from the draft IRP: *MWD is embarking on a course of action that will result in abandonment of MWD's historic investments in water supply infrastructure and low-cost core water supplies in favor of far more expensive water.* A graph illustrating this practical effect of the IRP is included as Attachment 1 to this letter. That graph shows that MWD's Buffer Supply strategy will lead to 500,000 acre-feet of imported water being stranded by MWD each year, in favor of more expensive local supplies developed by MWD at a cost of more than $1 billion annually on MWD's rates (2035). <u>It is imperative that MWD take the time now to refine this draft IRP to avoid creating stranded water and the associated stranded costs we will be asking our ratepayers to cover for decades to come.</u>

Detailed Comments on July Draft IRP

Our detailed comments are included in Attachment 2 to this letter in the following broad subject matter categories:

- *Water Rate Impacts*
- *Conservation*
- *Commitment to the Delta*
- *Stranded Costs*
- *Why Abandon Historic Investments and Low Cost Water?*
- *Respect for Local Autonomy*
- *Definition of Region*
- *Outdated Reliability Goal*
- *Need to Integrate Member Agency and Local Planning Data*
- *Failure to Identify Key Issues to Maximize Surface Storage, Groundwater Storage and Conjunctive Use*
- *The Problem with Water Insurance, aka "Buffer Supply"*
- *"Adaptive Management" Inadequately Defined*
- *Inaccurate and Incomplete Data*
- *Process Concerns*
- *Recommendations*

We met with our member agency managers to obtain their perspectives, comments and questions. The August 10 IRP forum in San Diego was well attended by our agency managers and many questions and comments were presented to you directly at that time. A list of those questions is included as Attachment 3 to this letter.

We request that MWD staff distribute a revised draft IRP once it has an opportunity to respond to comments and questions raised here and at the IRP Stakeholder Forums, and to review and reconcile the data in the report so that it is both internally consistent and consistent with MWD's Regional Urban Water Management Plan.

Please let us know what the timeline is for receiving your written responses to this letter and the questions asked at the IRP Stakeholder Forums. We hope to work with you to complete an IRP that will provide a solid roadmap for the future for all of Southern California.

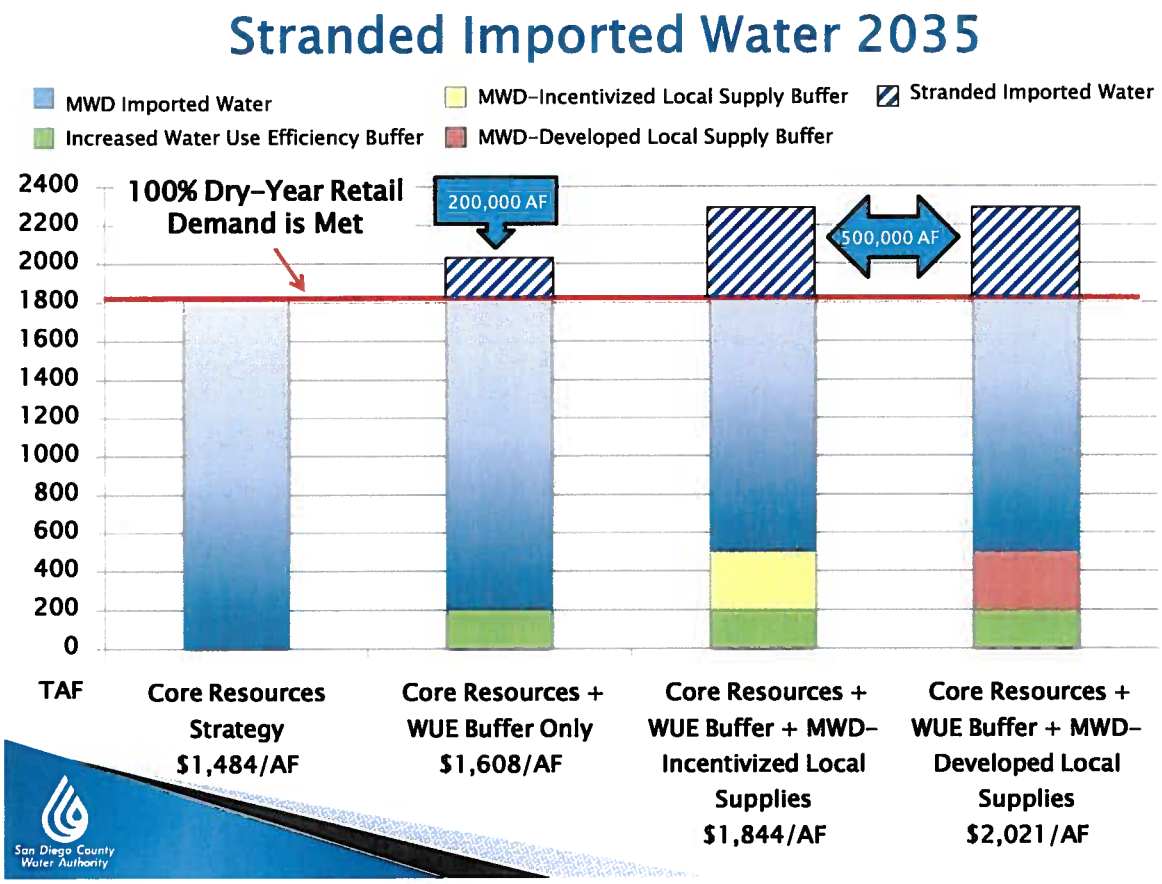
Sincerely,

Maureen A. Stapleton
General Manager

Attachment 1: Stranded Imported Water in 2035
Attachment 2: Comments on MWD's July Draft 2010 IRP Update
Attachment 3: Questions posted at San Diego IRP Forum

cc: MWD Board of Directors
MWD Member Agency Managers
Water Authority Board of Directors
Water Authority Member Agency Managers

ATTACHMENT 1– STRANDED IMPORTED WATER IN 2035



ATTACHMENT 2 – COMMENTS ON MWD'S JULY DRAFT 2010 IRP UPDATE

WATER RATE IMPACTS

With the unprecedented recommendation to develop 25% more water than MWD demands require, the draft IRP is extremely light on its analysis of potential rate impacts. The only rate analysis included in the draft was a table in Section 3 prepared for the board's strategic policy discussion and not related to the recommendation to implement the Buffer Supply. Presumably, the supplies being developed under the Core Resources Strategy would generally be lower in cost than those under Buffer and Foundational Actions. The implementation of the Buffer Supply will require substantial financial investment by MWD and its member agencies. A critical analysis of potential rate impacts and the impact rate increases will have on demand must be completed and deliberated by the board before it takes a policy direction on the IRP and implementation of a Buffer Supply.

In mid-August, MWD's staff presented a "2010 IRP Average Rate Analysis" on four implementation strategies for the IRP. The presentation showed the difference in the rate increase between the Core Resources Strategy – one that MWD admits meets all projected dry-year demand – and the plan's recommended strategy to develop 500,000 acre-feet of additional Buffer Supplies is only 2 percent, a deceptively and alluringly low number that obscures the actual difference in cost ratepayers would experience between implementing the Core Resources Strategy and any one of the three Buffer Supply strategies. The difference amounts to up to $537 per acre-foot in 2035 – a 36% difference in water rates in that year; this is not insignificant.

More troublesome, however, are some of the assumptions that went into the rate analysis. MWD currently funds about $20 million for its water conservation programs, which it projects would result in about 10,000 acre-feet of new conservation annually. Both the 20x2020 retail mandate and 20x2020 regional consistency require investment far beyond the current conservation effort. Under the 20x2020 regional consistency analysis, staff estimated 580,000 acre-feet of water use efficiency beyond that anticipated through current conservation programs is needed. Yet, only $20 million is assumed in the analysis to achieve the conservation goal that is significantly higher than what the current investment is producing. Similarly, the rate impact for Buffer implementation assumes MWD continues the $250 acre-foot subsidy for local projects development at the same time it is proposing investments in local water supply development that greatly exceed this cost. Another example: in the MWD-Developed Buffer Supply scenario wherein MWD assumes financial responsibility for 500,000 acre-feet of conservation and local supply development, MWD's operations would surely grow, yet the rate analysis shows zero cost difference in the Departmental O&M from the Core Resources Strategy; this appears to be an unrealistic assumption. Another example: zero cost has been assigned to account for the project development costs and risks associated with the Foundational Actions component of the plan.

MWD's failure to calculate or acknowledge the true cost of water by basing the rate impact analysis on unrealistic assumptions does a disservice to Southern California ratepayers and only pushes the hard decisions to another day. We request that a more realistic set of cost assumptions be used to conduct the rate analyses associated with the IRP and that this information be available for full discussion and deliberation by MWD's board of directors.

CONSERVATION

The Water Conservation Act of 2009 (the Conservation Act, or 20x2020) established new methodologies, water use targets and reporting requirements. The Act's requirements apply to urban *retail water suppliers*. Although MWD and its wholesale member agencies have a supporting role, primary responsibility for compliance with the law falls to each retail agency within MWD's service territory. The draft IRP does not address these requirements or explain how a regional program would integrate with, or support these retail conservation programs.

MWD's recent board memo on water conservation concluded that accounting for conservation at the individual member agency level would be too difficult and would threaten the efficacy of MWD's Integrated Resources Plan, Water Supply Allocation Plan and other programs. We respectfully disagree, and point out that local agencies already do so as part of their Urban Water Management Plans (and other plans). It is imperative that the MWD board consider changed circumstances and legal requirements to ensure that any future regional conservation program integrates with local programs, and avoids creating conservation disincentives through the pricing structure, water supply allocation plan, or otherwise.

While the draft IRP appears to *assume* a regional compliance approach, the Conservation Act provides that urban retail water suppliers must achieve and report compliance on an individual basis unless certain prerequisites for regional compliance and reporting are met. Among other things, regional compliance requires the written consent of each retail agency. MWD should factor this legal requirement into its analysis in the revised draft IRP.

Indeed, as a wholesale water provider, MWD's role in conservation must be carefully evaluated in light of these new legal requirements. Since it is unlikely that all retail water suppliers within MWD's service territory will elect to report as part of MWD's regional water management group, MWD must account for that as the regional program is being developed. MWD must carefully assess how a regional program can fairly integrate with the individual programs its member agencies, and their respective retail agencies, choose to implement to ensure that each retail agency and group of ratepayers is carrying its legally required, fair share of the cost.

Changes will also be necessary to MWD's water shortage allocation plan in order to encourage conservation. The City of Long Beach has presented a number of ideas and approaches to address this concern that should be thoroughly evaluated and considered. We also believe that MWD's wholesale price structure discourages conservation by disguising the true cost of alternative water supplies. By continuing to offer regional subsidies to retail agencies to meet water use efficiency targets that are legally required of them, MWD is actually discouraging water conservation – unless, that is, MWD pays for it. Any regional program must <u>start where the legal requirement on the retailers *ends*</u>, otherwise, MWD is simply robbing Peter to pay Paul and rewarding free riders. And, by subsidizing compliance with the retail 20x2020 targets, funds that MWD collects from some of its member agencies will be benefitting (subsidizing) compliance of other member agencies while providing no commensurate benefit to the "donor" agencies, because those donor agencies do not receive "credit" toward their own 20x2020 compliance goals for spending money (via the MWD subsidies) in other retailers' service areas.

These donor agencies must additionally spend their own rate money to meet their own compliance requirement.

As noted earlier, we believe that measurement and verification are essential to any water use efficiency program, and is in fact, required for compliance. We would note that the data MWD uses to support the conservation section of the IRP is, except for the current demographic data from SCAG and SANDAG, outdated (Attachment A.1, Attachment C-2) (1997). One of the recommendations in the 1997 report was that MWD expand the coverage of its conservation data base to include the many MWD member agencies with respect to which conservation data was not available. (See IRP Attachment A-1 at Attachment C-40)

We believe there is an important role for MWD in water conservation but that its programs must change in order to address the concerns described above. The draft IRP fails to address these important considerations.

COMMITMENT TO THE DELTA

Many agencies and stakeholders are reading the draft IRP recommendation to "immediately" and "aggressively" implement 500,000 acre-feet of Buffer Supply as a signal that MWD is abandoning, or does not believe that it will be successful in fixing the Delta. This comes as a big surprise to our community, which worked tirelessly on the 2009 water bill package and water bond. We do not support changing course and believe that we must diligently pursue and protect our investment in the Delta and State Water Project. The Delta Community is also counting on our continued support. It is our understanding from the information provided by MWD that the Core Resources Strategy includes both a Delta Fix and continuation of existing Colorado River programs contemplated by the Quantification Settlement Agreement. We believe this is the correct approach and consistent with MWD's core mission.

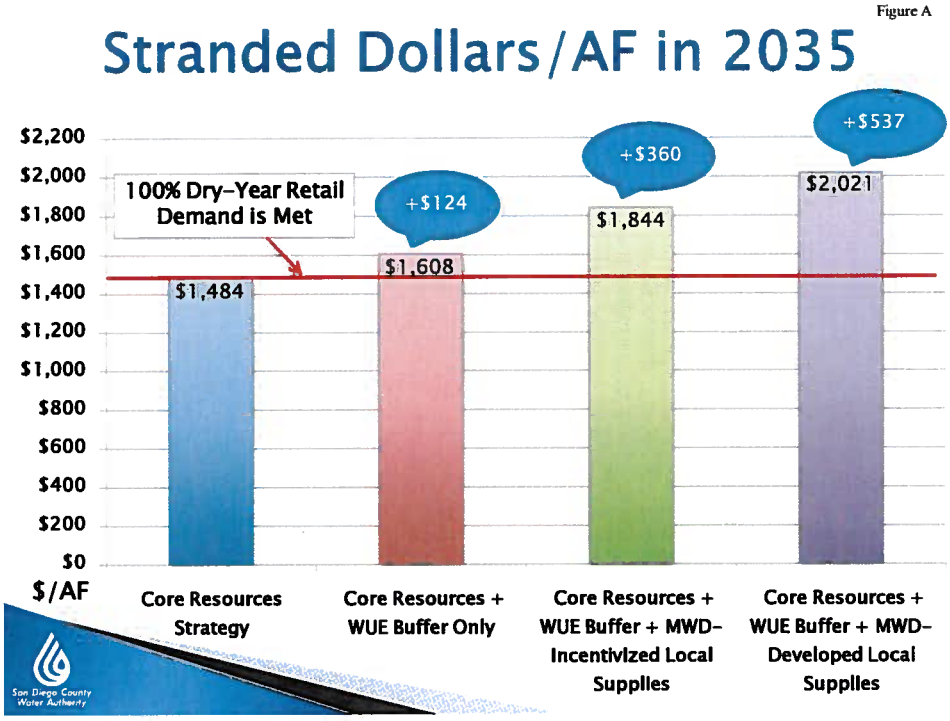
This having been stated, the Water Authority is open to having a candid discussion with MWD, the Delta Community and all interested parties about the nature and extent of the Delta "Fix," if MWD has grown skeptical of the prospects for success in the Delta. In the meantime, and unless and until a *conscious decision* is made – with the benefit of analysis and input from all affected parties – we believe the call for a Buffer Supply sends the wrong message vis-à-vis MWD's intentions in the Delta – and an expensive message at that.

STRANDED COSTS

Since the drought in the early 1990's, MWD's water management strategy has been to invest in storage to take advantage of the hydrologic cycles to best utilize low-cost, available water. Today, this investment, which stands in excess of 5 million acre-feet of storage capacity, has served the region well during the current supply challenges. But, rather than continuing this management strategy to optimize the historic investment in the State's water supply infrastructure and MWD's own low-cost imported water, the draft IRP proposes to shift course in favor of MWD developing local water supplies at a high cost to its ratepayers.

The development of the Buffer Supplies would lead to a similar outcome. If these supplies are not needed – and the draft indicates that demands for the Buffer Supplies will not exist – then the costs to develop them are truly in excess of need and stranded and, therefore, will be stranded costs. A graphic illustration of the stranded costs is shown below in Figure A.

Figure A



It is important that MWD integrate its planning with those of its member agencies so that it does not find itself with stranded investments and future unexpected rate increases due to poor planning.

WHY ABANDON HISTORIC INVESTMENTS AND LOW COST WATER?

Staff's rate analysis released in mid-August sheds light on the following facts: the immediate implementation of Buffer Supply, whether limited to regional consistency Water Use Efficiency of 200,000 acre-feet or the entire 500,000 acre-feet inclusive of local projects would result in abandonment of like amounts of lower-cost imported water, even after it has obligated its share of the Delta Fix improvements. Case in point, in 2035, with Buffer Supply inclusive of Water Use Efficiency only, MWD's own rate analysis showed it would forgo a like amount of imported water due to reduction in sales. The situation worsens if MWD implements the entire 500,000 acre-feet of Buffer Supply, under both MWD-Incentivized and MWD-Developed Buffer Supply scenarios, 500,000 acre-feet of imported water is forgone. Why would MWD spend billions of dollars to develop new supplies and, at the same time, plan to forego use of those supplies?

RESPECT FOR LOCAL AUTONOMY

The key question addressed in the draft IRP focuses on the "role" of MWD. But, with due respect, we believe it's the wrong question. The focus should not be on MWD's "role," but on how the most reliable, cost-effective water supply can be provided to water ratepayers, being

mindful that not every retail water supplier or even every "region" within the vast MWD service territory will answer that question the same way. MWD's "top-down, all-in" planning model in which it will assume responsibility over local water supply development fails to take into account the many cities, local agencies and groundwater managers who grapple with local water supply development issues every day. It is an open question what role these agencies and water suppliers would like MWD to play, but it is certainly important to ask. Historically, the answer to that question would be easy: they want funding to help support local water supply development. We believe that there *is* a role MWD can play in helping to support local projects including funding mechanisms for local supply development. But the rules must be firm and fair, laid out in advance, and equitable to all parties.

DEFINITION OF REGION

Given the dramatic shift in the draft IRP from imported water supplier to local supply developer, MWD should take a step back and ask itself, its member agencies and, critically – the hundreds of cities, counties, water suppliers, groundwater managers and other local districts – how they define their "region" for purposes of local water supply development. MWD has been Southern California's principal "regional" *imported* water supplier. That does not mean that it will be efficient or even logical for MWD to become Southern California's "regional" *local* water supplier. The State, for example, recognizes nine separate IRWM planning groups that are wholly or partially within the MWD service territory. What makes sense for "regional" local water supply development needs to be discussed between and among all interested parties, not just MWD and its member agencies, and be defined in a manner that is practical, workable and equitable to all parties. It is likely that not all local and regional agencies desire to be under the planning umbrella of MWD and its member agencies – whose member agencies often have goals, priorities and objectives that are different than their own.

OUTDATED RELIABILITY GOAL

By declaring allegiance to the 1952 Laguna Declaration, the draft IRP misses a critical opportunity to signal that it is no longer "business as usual" in Southern California or at MWD. Indeed, where and how to establish the reliability goal was not even discussed as part of the IRP process. In today's water-scarce, high-rate environment, our customers want a choice about the level of "regional" reliability they want to pay for.

But the draft IRP goes even further, it advocates a reliability goal of developing core supplies to meet full-service dry year demands at the retail level under all foreseeable hydrologic conditions, *plus* developing a Buffer Supply of 10% of retail demand, *plus* completing project planning for an array of additional projects based on undefined "uncertainty" (the Foundational Actions). This "Laguna Declaration-*Plus*" approach is excessive, impractical and fiscally imprudent. It also flies in the face of California's changed circumstances and Southern California's conservation ethic.

Before staff recommends the highly aggressive supply development outlined in the draft IRP, it should communicate with each of its member agencies to determine the extent to which those

agencies intend to rely upon MWD to meet their future supplemental water supply needs. As aptly noted in the 1994 Blue Ribbon Task Force Report,

> "[It was troubling] to learn, for example, that some of the member agencies most strongly supporting big-ticket projects...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 customers." -- BRTF Report at page 23.

Just as in the past, it is clear that some of the MWD member agencies most strongly supporting the draft IRP are doing so precisely because they believe that it will allow them to become <u>less dependent upon MWD</u>.

NEED TO INTEGRATE MEMBER AGENCY AND LOCAL PLANNING DATA

The draft IRP identifies the need for only 16,000 acre-feet of local projects to achieve the Core Resources Strategy target in 2015 and only 46,000 acre-feet by 2025 and through the end of the planning horizon (2035). According to the draft IRP, this will result in 100% supply reliability under all hydrologic conditions to meet dry-year demand. It is important to note that in reaching the 100% reliability assessment, the plan has taken into account regulatory and environmental constraints on supplies from the Bay-Delta in the years before mid- and long-term Delta improvements are completed.

Based upon review of the limited data included in Appendix A.5 of draft IRP, it appears that as much as 750,000 acre-feet of local water supply is already being planned by MWD member agencies. It is unclear whether this list includes all supply projects that are being planned by cities, groundwater managers, replenishment districts, utilities and other agencies and water suppliers throughout Southern California. Given that the draft identifies only 46,000 acre-feet of local projects is needed to achieve Core Resources strategy's 100% reliability goal, the draft IRP fails to grapple with the reality that MWD sales will be <u>reduced, not increased</u> in the future. If properly coordinated, this trend can be a positive outcome for MWD and all of Southern California. But MWD threatens to disrupt the positive economic impacts of this shift by proposing to over-invest in new water supplies in an ill-fated and illusory attempt to increase its own sales. Failure to coordinate with the many cities, water districts, and utilities beyond MWD member agencies places all Southern California water ratepayers at risk.

The draft IRP also does not provide projected supplies under average- and wet-year hydrologic conditions and their frequencies of occurrence. The draft shows only how MWD's storage would fare under "average" conditions. Figures 4-5 and 4-6 reflect very healthy storage conditions for MWD, but lack data for member agencies to assess how their surface reservoir or groundwater basins could be augmented for dry year use.

In summary, although the IRP by definition is intended to be an *integrated* plan that takes member agency and retail supply plans into account as part of MWD's regional planning, the

IRP draft fails to do so. This presents grave risk to MWD and Southern California water ratepayers.

Finally, MWD's historic and principal role has been to deliver water to Southern California imported from the Colorado River and State Water Project. The subsidy programs were originally created to "encourage" conservation and development of local water supplies that were otherwise not cost-effective, and, in order to "send the right message" to Northern California where it was seeking to maintain its State Water Project entitlement. The rationale was that by supporting these local water supply investments, the costs of securing additional imported water supplies and/or infrastructure were "avoided," and thus the payment of MWD subsidies benefited the region as a whole. MWD should take the time now as part of the IRP planning process to consider the appropriate role of subsidies generally, and including whether subsidies are encouraging or impeding desired outcomes.

FAILURE TO IDENTIFY KEY ISSUES TO MAXIMIZE SURFACE STORAGE, GROUNDWATER STORAGE AND CONJUNCTIVE USE

The draft IRP says that Metropolitan has "gradually shifted from being exclusively a supplier of imported water to collaborating with its member agencies on regional water supply planning issues." This statement does not capture the momentous change that is being recommended for adoption in the draft 2010 IRP, which will place MWD in control of planning, outreach, all state and federal funding and decision-making about local project development. While the draft promises that MWD will "collaborate" with agencies outside of their own member agencies, it appears that it has not collaborated with them in proposing this new role for MWD in the first place. Willingness to allow MWD to become the regional master facilities planner may also vary by region.

MWD's principal, historic role has been as a supplemental, imported wholesale water supplier to its member agencies. While "collaboration" with its member agencies is indeed important, MWD is announcing in the draft IRP a substantially different and enhanced role for itself in the future, including "master planning" for significant local water supply resources over which it has no legal jurisdiction or expertise. The draft IRP does not so much represent a "gradual shift" as a takeover strategy for local water supply development in which MWD will be in charge of local water supply development through its regional master planning process. For example, MWD is declaring that it will be in charge of "master planning" for the following activities:

1. Recycled water development, including creation of a regional finance committee that will determine how all state and federal funding dollars are best spent (Table 5-5);
2. Preparation of salt management plans and groundwater basin management plans (Table 5-7);
3. Seawater desalination "integration" (Table 5-10) and funding mechanisms (Table 5-13); and,
4. Stormwater capture, including regional master planning, implementation of pilot projects and development of subsidy programs (Table 5-19).

MWD's newly announced role as "master planner" for all Southern California local water supply development goes far beyond the function of "collaboration" described above. Given that it has little expertise in groundwater and developing local projects, staffing and budget increases will undoubtedly be on the horizon. These efforts will duplicate those of the many local water suppliers, replenishment districts and groundwater managers who are already engaged at the local level.

In lieu of these proposed changes, MWD should follow the same, more cautious guidelines it suggests for graywater (see page 5-36), namely,

1. Do not establish subsidies to pay for graywater;
2. Focus instead on reviewing and suggesting standards and pursuing changes to legislation and regulations to support graywater development;
3. Work with local entities to create model guidelines for permitting processes; and,
4. Assist with public information efforts as requested and appropriate.

Finally, the draft IRP fails to address the most fundamental questions that must be addressed by MWD at the wholesale level, including: 1) how available imported water supplies will be managed; and 2) what policies are needed to assure fair access to facilities in order to move water stored in groundwater basins in and out of, and within the MWD distribution system.

THE PROBLEM WITH WATER INSURANCE, AKA "BUFFER SUPPLY"

The draft IRP recommends implementation of the Buffer Supply as an insurance policy against uncertainties, but does not provide a quantitative analysis or risk assessment to show how the 500,000 acre-feet of supply development was derived. For this reason, the Buffer Supply is purely speculative.

The Buffer Supply is also financially unsustainable under the current rate structure, since agencies would only pay for the "insurance" when they file a "claim" for the water. The cost of maintaining a large "standby" supply will be extraordinarily expensive, force MWD rates to increase exponentially, and, drive water purchasers away from MWD in search of lower cost supplies that they can control. Here again, the 1994 Blue Ribbon Task Force had it right:

> "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." -- BRTF Report at page 9.

While the draft IRP itself is silent on the cost of the Buffer Supply, MWD's mid-August rate analysis showed startling costs of the Buffer Supply, in terms of sky-high water rates, stranded water supply and stranded costs. The two charts included with these comments were developed based upon this mid-August rate analysis.

Furthermore, the draft IRP appears to ignore the fact that MWD already has a substantial "Buffer" in which it has invested, namely, MWD's vast storage program. MWD has 5 million acre-feet of storage, which the draft IRP indicates will be full on average. The draft IRP also says that if the Core Resources Programs are implemented, the region could have an excess of 1 million acre-feet of water during dry years, when storage and transfers are factored in. If the 500,000 acre-feet Buffer Supply is implemented, *without* MWD taking any water from its storage, the region will have more water than required to meet demands including filling all available storage. The bottom line is that the draft IRP fails to factor in that the very purpose of the existing storage is to provide the same dry year assurance that is proposed to be filled by the new Buffer Supply.

"ADAPTIVE MANAGEMENT" INADEQUATELY DEFINED

Although the draft IRP says that MWD will employ an "adaptive management" strategy, the draft also concludes that an aggressive approach to immediately implement the Buffer Supply is required. In general, it is not possible to discern from the draft IRP what the timing or "triggers" are for any of the "adaptive" actions. The draft IRP is also inconsistent with statements made by MWD staff at the August 10 San Diego Stakeholders Forum with regard to timing of adaptive management actions described in the draft IRP.

At its own August 20 member agency managers' meeting, MWD staff stated that it plans to only recommend immediate implementation of the regional consistency Water Use Efficiency Buffer, and leave the implementation of the Local Resources Buffer to occur only when certain trigger events take place, such as failure to obtain the environmental documentation for a Delta conveyance facility by a date-certain (yet to be specified). This is a very different position than the draft's aggressive approach to implement local projects as delineated within the draft IRP as follows:

> Page 4-20, "Implementing a Supply Buffer," states, in part: "...a 'planning' Buffer was introduced during the 2004 Update. The 2010 IRP Update proposes to expand the concept of a planning Buffer and <u>create an actual hedge</u> against demand uncertainty, by <u>implementing</u> a supply Buffer equivalent to 10 percent of total retail demand. Metropolitan will collaborate with the member agencies to <u>implement</u> this Buffer through complying with the 20X2020 legislation, and by <u>implementing aggressive</u> adaptive actions to meet any remaining portion of the 10 percent Buffer." (Emphasis added.)
>
> On page ES-8, the draft states: "Maximizing regional benefits through economies of scale and minimizing the cost of redundancy is important to adaptability. The 2010 IRP Update <u>will</u> hedge against demand, supply and environmental uncertainties by <u>implementing</u> a supply Buffer equivalent to 10 percent of total retail demand. This Buffer <u>will be implemented</u> through meeting 20X2020 water use efficiency goals, and by <u>implementing aggressive adaptive actions</u> to meet the remaining portion of the 10 percent Buffer through local supplies and transfers. This approach is consistent with maintaining reliable baseline supplies and advancing local and regional solutions." (Emphasis added.)

> In its outreach materials used at the IRP Public Forums, MWD has an executive summary, page ES-10, that states the Buffer Supply will be "...developed through collaboration with the member agencies on aggressive actions." And, on Figure ES-4, Component 2 box reads "aggressive adaptive actions for the remainder." (Emphasis added.)

It is impossible to reconcile the oral comments made by MWD staff at the August 10 Stakeholder Forum and the August 20 MWD Member Agency Managers meeting with the conflicting verbiage in the draft IRP document.

It is also completely unclear what "adaptive management" means or how it will be employed by the MWD staff once the IRP is adopted by the board. Substantially more detailed planning and transparency is required before board adoption so that the member agencies can better understand what is intended by the draft IRP.

INACCURATE AND INCOMPLETE DATA

The Core Resources Strategy is the heart of MWD's current water supply planning. It is essential that the draft IRP provide a full description of the components of the Core Resources Strategy. And yet, it is not possible to discern the details of the Core Resources Strategy due to the fact that there is inconsistent data presented throughout Sections 4 and 6 of the draft IRP. These are the key sections of the report that present analyses of the available water supplies and need to develop additional supplies.

To ensure a sustainable resource plan that clearly outlines a path for long-term reliability, it is fundamental that the draft IRP start with a more comprehensive evaluation of the Core Resource Strategy. The Core Resource Strategy serves as the foundation of the plan. The analysis should include an identification of what actions can be taken to strengthen the core strategy in order to maximize investments already made in imported supplies. The evaluation should include an assessment that clearly identifies the risks associated with implementation of the core strategy and takes adaptive measures to mitigate those risks. This assessment would provide a linkage between the Core Resource Strategy and the timing and type of adaptive management strategies recommended. Transparency in the process is critical to providing the member agencies the data and information needed to plan accordingly in their UWMP and resource plans.

In addition to the internal inconsistencies, the data included in the draft IRP is also inconsistent with data included in MWD's recently released draft Regional Urban Water Management Plan (RUWMP). The Water Authority suggests that MWD staff conduct a workshop with the member agency managers to work through this detail so that MWD's Core Resources Strategy can be presented in a manner that may be better understood and inconsistencies with MWD's RUWMP can be reconciled.

To cite just a few examples, seawater desalination is listed as existing production on Table 4-6 but as a yet-to-be-developed Core Resource on Table 4-8. There is no indication how the groundwater, local surface water and Los Angeles Aqueduct (LAA) supplies listed in Table 4-7 were projected. And, it is unclear why there is an increase in groundwater supplies during this

planning horizon, but a decrease in surface water. The data for LAA also differs between the IRP and RUWMP. These and other inconsistencies and lack of foundational data are not "details" to be "worked out later" – rather, this is foundational information required in order to meaningfully assess MWD's current supplies and the need to develop additional supplies.

Beyond the internal inconsistencies in the draft IRP, there is also insufficient information provided on the plans of cities, groundwater agencies, replenishment districts, utilities and water suppliers throughout the Southland to implement conservation and other local water supply programs that will substantially reduce the amount of water purchases from MWD in the future. While the draft notes that there are approximately 250 retail agencies that supply water to the public, the draft IRP analysis has failed to account for the plans and timing of plans that many of these 250 retail agencies have to both conserve water and develop local resources. Although Appendix A.5 includes a list of member agency area projects, it does not provide analysis to show how these projects will reduce the demand for MWD supplies. It also does unclear whether it includes projects of the many agencies, sub-agencies and utilities who presently buy water from MWD member agencies. MWD must work with its member agencies to develop an accurate and agreed upon list of projects as well as project timing, and eliminate inconsistencies before it finalizes the draft IRP.

Moreover, MWD's methodology limits its accounting of local supplies to existing, under construction and "committed" projects (a term not defined in the draft IRP). All other planned local projects are included as part of MWD's own "regional" target, with the explanation that, "... [t]his recognizes the uncertainty in local supplies and avoids over and under allocating local supply targets to individual agencies" (see Appendix A.1-22, "Projected Active Conservation: A New Approach). This approach appears grounded in MWD's past experience and the notion that local water suppliers cannot be relied upon to develop local supplies and, therefore, MWD must step in and take over responsibility for local supply development. This assumption fails to take into account the substantially changed circumstances and that many local water supply projects that were once uncompetitive with the price of imported water are now cost-effective – without any subsidies from MWD – when compared to even the conservatively projected cost of MWD water. There are also better mechanisms to hold local water suppliers accountable to the region for completion of projects than the theoretical no-cost or low-cost water supply Buffer "insurance" recommended in the draft IRP.

The realistic regional demand "gap" cannot reasonably be estimated without taking into account the existing and planned actions of MWD's member agencies and other local water suppliers. The draft IRP notes that Metropolitan has historically provided between 45 and 60 percent of the municipal, industrial, and agricultural water used within its service area. However, enhanced conservation and development of local water supplies will result in a dramatic reduction in water demand on MWD. Implementing any of the Buffer Supply strategies in the draft IRP will lead to unavoidably higher rates and inversely declining sales.

PROCESS CONCERNS

While there have been a large number of meetings and IRP-related "processes," the process overall has been both "top down" and "disintegrated," with no meaningful opportunity for non-MWD member agency participants to shape the outcome. This shortcoming is all the more important given the draft IRP proposes that MWD become responsible for, or compete with many local projects that are currently within the jurisdiction of cities, local agencies and groundwater managers. The 1994 Blue Ribbon Task Force made similar observations about the then-pending IRP process:

> "Although both the IRP and rate structure efforts largely 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." -- Blue Ribbon Task Force Report (BRTF Report) at page 8.

> "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." -- BRTF Report at page 12.

> "Despite a heavy meeting schedule, and numerous specialized committees and subcommittees, the Board often seems to be presented with limited options and choices for final approval largely defined and developed by MWD staff, rather than conduct an independent inquiry of relevant matters." -- BRTF Report at page 74.

These observations are as accurate regarding the current draft IRP and IRP process as they were more than 15 years ago. The 2010 draft IRP has been available for public review only recently, and although voluminous, contains limited information. The revised draft IRP will apparently not be available until later in September, with board adoption scheduled for October. This schedule and process does not allow for meaningful distribution or review of the draft IRP by those who are impacted through the adoption of the IRP. MWD staff has been portraying the draft IRP as implementation of the will of the people, rather than as a recommendation of MWD staff. But, of the almost 19 million people who live and work in Southern California, less than 350 people attended the four stakeholder workshops combined – and, many of those participants were MWD and member agency staff and consultants. Moreover, the stakeholders were being asked to comment on a draft report in which fundamental questions remain to be answered.

Given that MWD is proposing to change its historic role as imported water supplier – which is the principal responsibility most local agencies now associate with MWD – it is vitally important that sufficient time be allowed for distribution to city councils, county board of supervisors, groundwater managers, replenishment districts, water districts, utilities, and other local entities which will bear the expense of, or otherwise be impacted by MWD's new role. MWD and its member agencies should not simply assume that all agencies and stakeholders will welcome this new role for MWD or the associated rate increases that will be necessary to implement this course of action.

RECOMMENDATIONS

MWD uses the IRP as a foundation for its RUWMP. Thus, the draft IRP should reflect the clear professional recommendation of MWD staff. Is that the case? If so, we recommend you say so when the revised draft IRP is released. As it stands in the draft IRP, this is unclear.

At a minimum, we recommend that MWD provide a full 60-day review period between the release of a revised draft IRP, including responses to all comments and questions, and the first MWD board meeting to consider the revised draft. We also recommend at least two public meetings of the board to consider and deliberate the revised draft IRP. This time frame would still allow adoption of the IRP in advance of the RUWMP. Although the update process stated more than a year ago, the recommendations were made available for the first time in July 2010 when draft report was posted online. We were quite surprised with the recommended strategy, especially since the draft's own data indicates the excessiveness of such a recommendation. The draft recommends an adaptive strategy that included three components: Core Resources Strategy, Buffer Implementation, and Foundational Actions.

The draft IRP clearly indicated that the implementation of the Core Resources Strategy would meet projected dry-year demands under all foreseeable hydrologic conditions, with MWD's 5 million acre-feet of average storage capacity above 60 percentile and probability of dry-year shortage diminishing to zero past 2015 (with only than less than 1 percent shortage in 2015). Yet, it recommends moving forward with all three components concurrently, including aggressively pursuing Buffer Supply implementation (in contrast to 2004 IRP's planning buffer) and at the same time developing large-scale projects so they are "ready to proceed" under Foundational Actions.

The forthcoming revised draft IRP must integrate member agency plans and projects into the discussion, and before implementation of projects that exceed demand, member agencies' commitment to pay for these supplies must be obtained and proper choice and structure be set in place to ensure MWD does not strand water nor investments under the new supply strategy.

ATTACHMENT 3 – QUESTIONS POSED AT SAN DIEGO IRP FORUM

RELIABILITY GOALS

- Doesn't the IRP's reliance on the almost 60 year old Laguna Declaration – drafted at a time when Southern California was almost completely dependent on imported water – send the wrong message in today's limited resource and escalating cost environment? Is that a smart message in the water bond campaign?
- Why didn't MWD reconsider the central question of the where the regional reliability goal should be set?
- Why should everyone have to pay for the same reliability standard if they want to conserve more and pay less?
- How has MWD accounted for the dampening effect higher prices will have on water demand?

SUPPLY AND PLANNING BUFFER

- Has MWD done a survey of each of its member agencies and other local agencies and utilities to determine what projects they are developing now or plan to develop in the near future? Don't you need this kind of information in order to determine what supply "gap" exists?
- Will MWD staff agree to collect this information about local projects development and make it available before asking the board to adopt this IRP?
- What is the rationale for an MWD Buffer Supply equal to 10% of retail demand? What is that number based on?
- What is MWD's assumption in the IRP about who will pay for the core and Buffer supplies? Is there a breakdown of this by region or project? Isn't this information necessary to define even broad parameters of a real plan?
- Is staff recommending the implementation of both core and Buffer supplies because it does not believe it will be successful in the Delta Fix? If not, why does this draft recommend moving forward now with implementation of both supplies?
- Can you be more specific about the risks and uncertainties you believe justify the expenditure of current ratepayer dollars? What are the "trigger points" that would warrant increased spending?
- What is the level of commitment to developing the resources identified in the Buffer? And is there a certain date by which those resources will be developed?
- Why are recycled water and seawater desalination identified as part of the Buffer supplies?
- What is the size and composition of the Buffer?
- What is the process by which the region will make the decision to deploy elements of the Buffer? And are there risks associated with each trigger level?

MWD'S ROLE

- Isn't our current water supply allocation the result of challenges to our imported supplies? Since this has been MWD's historical role, shouldn't MWD focus its efforts and regional dollars on securing the Delta Fix and filling the Colorado River Aqueduct?

MEMBER AGENCY'S ROLE

- Does the IRP assume and recognize that the 20x2020 requirement is a retail obligation? Given that, why should MWD subsidize member agencies to meet this local mandate? Isn't this rewarding bad behavior?
- What is the IRP assumption about the project cost that would qualify for a financial "incentive" from MWD?
- Won't MWD by definition be investing in the most expensive sources of supply? [*Comment: If not, why would the local agency need an "incentive"?]*
- How does Met intend to ensure fairness among its member agencies in the collection and redistribution of incentive money for conservation and local projects?

PROJECT ASSUMPTIONS

- What is MWD's assumption on who will implement the 20x2020 mandate?
- What are MWD's planning assumptions for the on-line dates for the member agency projects described in the Appendix?
- What are MWD's assumptions for supply conditions under normal and wet years?
- What assumptions does the report make about how surplus water in any given year will be used? Will it go first to refill MWD's storage? Do you assume that discounted replenishment rates will be available at any time in the future? If so, under what conditions?

COST ANALYSIS

- What are the cost assumptions for core and Buffer Supply projects?
- What is the estimated rate impact as a result of implementing the core strategies? Is this impact based on an assumption the current rate structure remains unchanged?
- What would the implementation of Buffer Supply add to water rates?
- What about the Foundational Actions? How much would those activities add to water rates?
- Will MWD do a new rate structure analysis and cost of service study for IRP programs and projects before adopting the IRP?
- How does MWD ensure its core supply investments would not be stranded?
- Is MWD going to require firm contractual commitments from each of its member agencies to pay for all of this supply development?
- How do preferential rights relate to the availability of Buffer Supply water? Are they enforceable if a member agency claims them?
- Do you have any analysis available to show the "balancing" between resource investment and cost considerations?

TIMING

- IRP sets forth MWD's policy for future supply development and is an especially important document given changed water supply environment. Why the rush to get the report adopted so quickly?
- Are you willing to recommend extending the time for MWD staff to answer our questions before we are required to comment further on the report?

San Diego County Water Authority
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November 29, 2010

Carolyn Schaffer
Associate Resource Specialist
Metropolitan Water District
700 N. Alameda Street
Los Angeles, CA 90012

RE: Metropolitan's Draft Long Term Conservation Plan

Dear Ms. Schaffer:

Thank you for the opportunity to provide comments on Metropolitan's Draft Long Term Conservation Plan. The Water Authority's comments are attached.

I look forward to discussing these comments and those of the other Metropolitan member agencies at the meeting on Wednesday, December 1, 2010.

Sincerely,

William J. Rose

William J. Rose
Water Conservation Program Executive

WJR:tp
Enclosure: Long Term Conservation Plan Comments
cc: Amy Chen, MWD Program Chief

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Summary Comments on MWD's Long Term Conservation Program (LTCP)[1]

The LTCP must recognize that conservation is a core supply

- The LTCP should clearly state that the *20% water use efficiency target is a core water supply* and not part of the "uncertainty buffer." MWD should also reduce its target of alternative water supplies to be developed by the amount of water included in the water use efficiency target.

- The LTCP should reflect that retail agencies have choices of compliance options to meet the 20x2020 requirements. After taking into account the cumulative conservation of the retail agencies within its service territory, *MWD should develop additional "water use efficiency" supplies as part of core water supplies*. The cost of these supplies should be competitive with the avoided cost of alternative water supplies available to be developed by MWD. As a *supplemental, wholesale water supplier* – and particularly in the current high rate environment – MWD must develop lower cost supplies first.

Metropolitan's wholesale conservation programs should be grounded on a requirement that each retail agency pay for its own state-mandated 20 x 2020 compliance

- The LTCP should account for the 20x2020 compliance target as determined by the member agency, or by the retail subagencies served by the member agency. The MWD target cannot be established until the retail agencies have selected their respective compliance targets and methodologies. MWD should make it clear that retail agency compliance with statutory requirements is the foundation of the LTCP.

- The LTCP should provide a *structure to integrate retail compliance with 20x2020 requirements and allow for trading of conservation credits.* MWD should not pay subsidies to retail agencies to meet compliance requirements. MWD can facilitate retail compliance by creating a structure to allow for voluntary trading of conservation credits among member agencies.

- *MWD's LTCP as drafted encourages free riders and creates disincentives to water conservation in Southern California*. Wholesale pricing that understates the true cost of water sends a contrary price signal and obstructs market transformation at the retail level

- *MWD must determine whether it has authority to grant subsidies*. Before adopting the LTCP, MWD must evaluate its legal authority to pay subsidies to member agencies or retail sub-agencies to pay for 20x2020 compliance. This analysis is

[1] This Summary is intended to provide general comments and recommendations on the LTCP rather than respond in detail to the most recent draft. It is difficult to provide meaningful comments on the draft due to the draft's failure to define key terms or distinguish between conservation mechanisms that have widely differing costs and implementation features.

particularly important because of the recent passage of Proposition 26 by California voters.

- *Retail agencies are in the best position to implement market transformation.* Consumer conservation measures are imposed and implemented at the retail level. MWD can support implementation at the local level by working with industry groups and statewide retail suppliers like Home Depot and Rainbird. But MWD does not have the authority to regulate conservation at the retail level, and retail agencies need to have maximum flexibility as conservation programs make short term water use reductions more challenging.

Measurement and verification are essential components of conservation

- Sound conservation programs require *measurement and verification of conservation savings*. Measurement of water conservation solely by reference to average per capita water use throughout the MWD service territory as proposed by the LTCP is an insufficient foundation to support the expenditure of regional dollars and does not recognize the legal obligation all retail agencies have under current state law.

- MWD must implement a *system to account for MWD water supplies* that are available to each of its member agencies in order to have a baseline against which to measure conservation. MWD's *water supply allocation plan* should accommodate voluntary trading among member agencies.

MWD must send correct pricing signals in order to lay the foundation for conservation

- Price to the end user is a significant factor affecting conservation – *as the price of water goes up many consumers will choose to use less.* Significant research on retail price elasticity has already established this premise. MWD must *reform its wholesale rate structure* to send correct pricing signals to its member agencies to develop local supplies or increase conservation efforts. Wholesale pricing is an important component of market transformation at the retail level.

- MWD should *eliminate subsidies* for water conservation. Instead, MWD should *create and manage a "grid" through which retail conservation can be valued and traded.* This is a more appropriate and productive role for MWD and truly represents something it has the unique ability to do as a regional agency serving all of Southern California

MWD must rewrite the LTCP to define key terms and distinguish conservation options

- The LTCP must *define key terms and distinguish various conservation approaches* in order to assess which programs are better implemented by MWD at the wholesale level and which programs are better implemented at the retail level. As drafted, the LTCP does not distinguish regulations, subsidies, devices and full scale water reclamation projects, even though these various methods of conservation have

dramatically different costs and implementation considerations at the wholesale and retail level.

- In its current form the LTCP essentially says that MWD will make the conservation plan up as it goes along and essentially do "more" of what it has been doing in the past. This approach fails to grapple with problems of the past or provide creative leadership for the future of California water supply planning and management.

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July 20, 2011

Andy Hui
Manager, Regional Supply Unit
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Re: Comments on Long Term Conservation Plan Working Draft Version 11

Dear Andy:

This letter provides the Water Authority's comments on the latest draft of MWD's Long Term Conservation Plan (LTCP Draft 11).

The LTCP Draft 11 is obtuse. It is not possible to understand from the document what programs MWD intends to implement or even how or if water conservation will be measured by MWD or its member agencies. A board workshop should be scheduled so that the policy objectives and role of MWD in achieving those objectives may be clearly defined. Although the LTCP Draft 11 suggests creation of a Program Advisory Committee, the draft does not provide sufficient policy guidance to permit delegation of program implementation or further deliberation and decision-making by the member agencies. MWD's board of directors has a fiduciary responsibility to address these issues with more clarity and accountability than is provided in the draft LTCP Draft 11.

The Water Authority has previously provided significant comments on prior drafts of the LTCP, which have not been incorporated into or addressed in the LTCP Draft 11. The Water Authority's representatives on MWD's board of directors sent a letter in August 2010 providing comments on Board Memo 9-1, MWD Conservation Program (Attachment 1). The key recommendations contained in that letter were:

- MWD's LTCP must take into account the responsibilities all retail water suppliers have under the Water Conservation Act of 2009 (the Conservation Act) and structure a regional program that accounts for, integrates with and supports retail conservation programs.

- MWD's LTCP must require measurement and verification at the retail level to assure that its member agencies are in compliance with the Conservation Act, as a prerequisite to participation in MWD regional conservation programs.

LTCP Draft 11 fails to achieve either of these core objectives.

By letter dated September 10, 2010, the Water Authority staff provided comments on the conservation component of the 2010 Integrated Resources Plan Update (Attachment 2 at page 2). Although these comments relate directly to MWD's long term conservation objectives and policies, LTCP Draft 11 fails to address these comments.

Key recommendations regarding the LTCP were again provided in November 2010 (Attachment 3), including the following:

- The LTCP must recognize that conservation is a core supply, and MWD must adjust its supply program investments accordingly to match demands.
- MWD's wholesale conservation programs should be grounded on a requirement that each retail agency pay for its own state-mandated 20 x 2020 compliance.
- Measurement and verification are essential components of conservation.
- MWD must send correct pricing signals in order to lay the foundation for conservation.
- MWD must rewrite the LTCP to define key terms and distinguish conservation options.

LTCP Draft 11 also fails to incorporate or address these recommendations.

MWD must recognize that retail water suppliers have primary responsibility to establish and implement water conservation and that MWD's regional conservation objectives should target water use efficiency *beyond* what retail water suppliers are mandated to accomplish under the Conservation Act. MWD's proposed use of regional ratepayer dollars to fund subsidies to its member agencies to meet their conservation mandates is inconsistent with the law and good public policy. Subsidizing required retail conservation would reward agencies that have not invested in water conservation, punishing those who have done the right thing. MWD must treat regional conservation investments as part of its core water supply strategy and adjust its capital and financing plans so that the regional supply benefit of additional conservation beyond the 20 x 2020 retail mandate is achieved.

The LTCP Draft 11 purports to establish a target of 141 gallons per capita per day (GPCD) for the MWD region, but wholesale water suppliers are not required to establish and meet targets for daily per capita water use. The legal mechanism for wholesale water suppliers to serve that role is through a voluntary alliance of urban retail water suppliers documented by a formal agreement among those suppliers. MWD cannot assume that role without the written consent of each retail agency. Although the LTCP appears to propose a regional conservation plan, the draft fails to take into account any Department of Water Resources requirements for establishing a regional alliance. See http://www.water.ca.gov/wateruseefficiency/sb7/docs/MethodologiesCalculatingBaseline_Final_03_01_2011.pdf.

LTCP Draft 11 mentions "avoided cost" but no definition is provided. The LTCP must define how "avoided cost" is calculated and MWD capital and financing programs must be adjusted to ensure regional benefit.
The LTCP must also update the analysis of the "gap" the LTCP is intended to fill. Currently, the LTCP Draft 11 is based on the 1996-2005 average water use; however, substantial additional water conservation has already been achieved at the retail level and by MWD. The conservation target should be restated after recent water conservation and retail agencies' state-mandated requirements have been factored in. LTCP Draft 11 seems to suggest, based on historical patterns over the past twenty years, that recent achievements in water conservation will be short term or actually followed by an increase. However, the same circumstances do not exist today – when Southern California is facing long-term, regulatory supply shortages – as we had in the past during hydrologic drought cycles. The review of this issue should also take into account that *the cost of water has also increased substantially and this factor will continue to contribute to reduced water sales by MWD and its member agencies.*

Planning for MWD investments in local recycled water projects, if any, must be part of the conservation plan and regional benefit must be demonstrated. MWD should certainly pursue all low cost conservation measures before considering any investment of regional ratepayer dollars in local recycled water projects. Under the current water supply conditions, rate structure and IRP, there is no evidence that one member agency's recycled water project provides any benefit to other MWD member agencies.

LTCP Draft 11 states that "adaptive management" is needed to "rebalance" the conservation and recycled water targets that comprise the IRP water use efficiency target. This should be explained in the next draft.

The draft LTCP states that MWD's efforts will "focus on its strengths and opportunities as a large regional wholesale water agency." We believe this is the right approach for MWD, and that there are indeed, important roles MWD could play in achieving water conservation over and above the retail targets for 2020. However, this will require MWD to design a LTCP that factors in the retail urban water conservation that is required by each of its member agencies and to develop a regional plan in which the avoided cost of conservation above existing legal requirements base line can be measured. Unfortunately, the current draft fails to achieve this level of analysis or clarity.

Sincerely,

Meena Westford
Public Affairs Senior Manager

Attachment 1: Comment letter on MWD Water Conservation Program, August 16, 2010
Attachment 2: Comment letter on MWD 2010 IRP, September 10, 2010
Attachment 3: Comment letter on MWD's Draft LTCP, November 29, 2010

cc: Water Authority MWD Delegates and Board of Directors

San Diego County Water Authority
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August 16, 2011

Mr. Jeffrey Kightlinger
General Manager
Metropolitan Water District of Southern California
P. O. Box 54153
Los Angeles, California 90054-0153

Re: Member Agency Willingness to Sign Take-or-Pay Contracts
Request to Correct the Record of July 12, 2011 MWD Board of Directors Meeting

Dear Mr. Kightlinger:

During discussion of your business plan at the MWD Board of Directors meeting on July 12, 2011, Water Authority Director Lewinger asked if you would incorporate into your business plan several suggestions, including one specifically suggesting MWD secure take-or-pay contracts with its member agencies. In response, you stated that "…with respect to securing Board approval of firm take-or pay contracts, we discussed this for two years in 2000-2002 and staff comments of the Water Authority at the time were against take-or-pay contracts." Your statement is incorrect. In fact, the Water Authority has a long track record advocating that MWD obtain long-term take-or-pay contracts with its member agencies in order to stabilize its revenues and improve its fiscal sustainability. Indeed – please correct us if we are wrong – the Water Authority is the ***only*** MWD member agency that has indicated a willingness to make a firm funding commitment to pay for MWD spending programs.

Fifteen years ago, in 1996, the Water Authority made a proposal for a ***take-or-pay contract*** as outlined in its "Summary of Proposal to Resolve Colorado River and Rate Refinement Issues, dated April 22, 1996" (Attachment 1).

Later, as a part of the rate restructuring process for years 2000-2002, the Water Authority Board of Directors adopted, and then formally submitted a proposal to MWD's Board of Directors entitled "Framework of Key Contract Terms, dated February 17, 2000" (Attachment 2). The basic premise of the framework was that member agencies should specify by contract the water and services MWD would provide and a formula by which the agency agrees to pay for the water and services. Details of a ***take-or-pay contract*** between the Water Authority and MWD are included in Attachment F of the proposed framework. The framework sought to address many of the fiscal challenges that existed then, but which have grown far worse over the past decade. We asked the question at that time, on page 6, item 8: ***"Given the magnitude of its expenditures, is there any legally enforceable method other than take-or-pay contracts that can provide MWD with the certainty it needs to assure its fiscal integrity and stability?"***

As these documents – and many other comments by the Water Authority's staff and MWD delegates over the years – reflect, the Water Authority has long advocated that take-or-pay contracts with MWD's member agencies are necessary to address deficiencies in its revenue structure. Specifically, MWD continues to incur more and more fixed costs and debt obligations – amounting to more than 70 percent of its total costs – at the same time it has no financial commitments from its member agencies to pay for these costs. Instead, MWD continues to rely upon revenues from water sales, which today provide approximately 80 percent of MWD's revenues and yet are highly variable. The gulf between MWD's fixed expenses, at 70 percent, and fixed revenues, at 16 percent, is a key reason why MWD is in the worst financial crisis in its history.

More than 15 years ago, the MWD Water District Blue Ribbon Task Force (Blue Ribbon Task Force) found that the "greatest challenge" confronting MWD was the disconnect between its water supply planning process and its member agencies' actual willingness to pay (or not pay) for MWD programs (see generally, Task Force Report, *The IRP/Rate Structure Process and MWD Decision Making* at pages 5-9 and *The Integrated Resources Planning (IRP) process* at pages 10-15).[1] The Blue Ribbon Task Force found that:

- "An effective rate structure should generate sufficiently stable revenues to cover fixed costs" (page 15); and noted that,
- "Some of the member agencies most strongly supporting big-ticket projects…also had the most aggressive plans to reduce their future MWD water purchases and develop independent supplies." (Page 23.)

In order to address MWD's long term fiscal sustainability, the Blue Ribbon Task Force recommended that MWD's rate structures should ensure coverage of fixed costs without substantial modifications based on water use or other variable factors (page 20).

More than 15 years have now passed since the Water Authority and Blue Ribbon Task Force independently recommended that MWD adopt fixed payment commitments to address the growing instability of MWD's financial structure. At that time, the Blue Ribbon Task Force warned that, "[c]omprehensive rate structure revisions should not be further delayed, and pressing MWD revenue needs should be addressed as soon as possible." (Page 21.) Unfortunately, as you noted during your August 10, 2010 IRP presentation in San Diego (full quotation is included at Attachment 3), the rest of MWD's member agencies "…prefer it the way it is" and remain unwilling to sign take-or-pay contracts or other firm funding commitments to pay for MWD spending programs.

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[1] A second Blue Ribbon Committee was established by the MWD Board of Directors in January 2010. It has issued a Report, dated April 12, 2011, which has not yet been addressed by the MWD Board of Directors. Although the principal purpose of the 2011 Blue Ribbon Committee was to consider trends and uncertainties over the next 50 years that could affect MWD, it noted the importance of ensuring that the MWD rate structure provide a stable level of revenues to cover fixed costs – and, that if MWD's member agencies find they can procure water more cheaply and reliably from other sources, they will reduce their purchases from MWD. See generally, Report of the Blue Ribbon Committee dated April 12, 2011, *Finances and Pricing*, at pages 73-76.

At the same time the MWD board has refused to ask or require MWD's member agencies to commit to pay for MWD spending programs, it continues to adopt business and water resource plans that include massive spending for future State Water Project Bay Delta Conservation Plan costs, Integrated Resources Plan capital spending and long-term subsidy expenditures. While the Blue Ribbon Task Force appreciated the risk that was apparent more than 15 years ago ("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" (page 23)), MWD appears now to be reaching the breaking point due to reduced demands and implementation of member agencies' ongoing plans to buy less water from MWD. MWD's downward fiscal spiral is being hastened by the approval of more and more subsidies to its member agencies that will lead to even lower MWD sales – and revenues. Furthermore, the resumption of discount water sales by MWD in May of this year, which are displacing full service sales, will lead to even lower water sales revenues and continued operating budget shortfalls as MWD's spending is not curtailed to match its lower water sales.

While MWD's "Purchase Orders" are clearly no substitute for enforceable contracts, the expiration of the current Purchase Orders in December 2012 provides the board with another opportunity to address the deficiencies in the current financial structure and rate model. The Water Authority recommends that a ***board process*** be established as soon as possible to grapple with these issues. The Water Authority remains willing to execute a take-or-pay contract with MWD, and, to make the other tough decisions that are necessary in order to stabilize MWD's revenues and fiscal sustainability.

MWD's rising rates and debt burden, coupled with the lack of political will on the part of the MWD board to require its member agencies to commit to pay for MWD spending programs, is exactly the kind of political risk that was identified in the recent downgrade of our country's credit rating by Standard & Poors. In May of this year, the rating agencies noted that while MWD is heavily dependent upon variable sales of water for its revenues, its member agencies are not obligated to purchase <u>any water</u> from MWD, a finding that appeared to be a factor in Fitch Ratings' downgrade. We would like to work together with MWD staff and the rest of the board to avoid further downgrades of MWD's credit ratings.

Finally, the Water Authority requests that you correct the record regarding the statements made by you at the July 12, 2011 Board meeting discussion on the business plan. This can be accomplished by appending this letter, with attachments, to the July Board meeting minutes, as well as incorporating this letter by reference and attaching it to the minutes of the August 2011 board meeting – and we request that you do so.

Sincerely,

Fern Steiner, on behalf of the Water Authority's MWD Board Directors

cc: Water Authority Board of Directors
MWD Board of Directors
MWD Member Agency Managers

Attachments:

1. Summary of Proposal to Resolve Colorado River and Rate Refinement Issues, dated April 22, 1996
2. Framework of Key Contract Terms, dated February 17, 2000
3. Jeff Kightlinger quote from August 10, 2010 IRP presentation in San Diego

San Diego County Water Authority
A Public Agency
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April 22, 1996

John V. Foley
Chairman, Board of Directors
Metropolitan Water District
of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

Dear Jack:

Background Material for April 30, 1996 Metropolitan Board of Directors Meeting

In preparation for the April 30, 1996 special meeting of the Metropolitan Board of Directors, we have assembled the attached packet of information associated with the San Diego County Water Authority's presentation regarding Colorado River matters. Our objective at this meeting is to provide the Directors with information on the issues and respond to any questions. Our goal is that by the end of the meeting, the Directors will clearly understand the Authority's current positions regarding Colorado River issues and obtaining additional reliable water supplies for the benefit of the southern California region. We look forward to an open and productive meeting on April 30.

Sincerely,

Mark Watton
Chair, Board of Directors

Enclosure

4/22/96
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Proposal and Benefits

WATER TRANSFER GOALS

- Long Term, Reliable Supply
- Diversified Supply Sources
- Local Control
- Equality of Dependence on MWD
- Competitive Price
- Comparable Quality With Other Supplies
- Insurance Against Drought and Agricultural Cutbacks
- Investment Alternative
- Reduce Pressure on Bay-Delta Ecosystem

The Authority's Proposal
(Summary)

- Authority commits to purchase from MWD a minimum of 400,000 AF per year.

- Commencing in 1998, Authority would deliver to MWD 20,000 - 25,000 AF in exchange for delivery of an equivalent amount from MWD. Deliveries would increase to 200,000 AF/yr by about 2010.

- Commencing after 2010, Authority would deliver to MWD up to an additional 200,000 AF per year in exchange for delivery by MWD of equivalent amounts on a space-available basis.

- Cost of exchange water delivery is variable because fixed costs should be covered by annual requirement purchases and MWD premium water charges

- Assurance for blend of MWD water supplies
  50/50 Blend or 500 PPM TDS

- Cost containment in MWD CIP and Water Management Programs consistent with agency commitments and revised demand forecasts.

- MWD would put in place contracts for agricultural water discount.

- MWD support for Authority transfer facility and Authority willingness to discuss storage opportunities.

- Support for River reoperation and banking per California position.

- Provisions for dispute resolution.

San Diego County Water Authority
Summary of Proposal to Resolve Colorado River and Rate Refinement Issues

Revised 4/22/96

Annual Requirement Purchase Commitment. Currently there is no obligation for MWD member agencies to use or pay for MWD system improvements and State Water Project obligations. Consistent with the Rate Refinement Process, the Authority proposes to commit to purchase 400,000 acre-feet per year of supplies from MWD (Figure 1). The price and terms of delivery would be set by MWD in accordance with its governing rules and procedures, as applied to all member agencies. Any purchases by the Authority above this annual requirement could be charged a premium, as applicable to all MWD member agencies. MWD member agency purchases of annual requirement supplies, together with funds received by MWD from additional "premium" sales as proposed in the Rate Refinement Process, should fully offset MWD's fixed costs.

Water Exchange Program. To offset its current position with respect to preferential rights, the Authority proposes to deliver up to 200,000 acre-feet per year of supplement supplies to MWD, and have MWD deliver a like amount of water to the Authority. The quantity of water exchanged would begin at about 20,000 to 25,000 acre-feet per year, and gradually increase over a period of at least 10 years. In the event of a shortage, the Authority could receive reduced deliveries, if deliveries of supplement supplies would place the Authority in a preferred position relative to other member agencies.

An additional 200,000 acre-feet per year of supplement would be exchanged with MWD on a space available basis. Availability of space for delivery of additional supplement to the Authority or any other member agency desiring to do so, would be allocated in proportion to the annual requirement commitments made by each agency.

Means of Delivery. MWD would determine the means by which it delivers water to the Authority and other member agencies.

Cost of Delivery. The Authority would pay the full variable cost of delivering supplement water and additional supplement, reflective of the rate for all MWD deliveries of non-MWD water to other member agencies. No cost shifting would occur, since MWD should fully offset its fixed costs from its sales of Annual Requirement and Premium water.

Water Quality. MWD would meet applicable water quality standards for water it delivers to its member agencies, including the 500 PPM TDS standard, once MWD's Eastside Reservoir becomes operational.

Capital Expenditure Review. MWD and its member agencies, including the Authority, would review and reduce the CIP commensurate with member agencies' commitments to purchase future supplies, and other relevant facts.

Agricultural Water Sales. Agricultural water users would continue to be provided a discount commensurate with the value of interruptibility and other benefits of agricultural water sales.

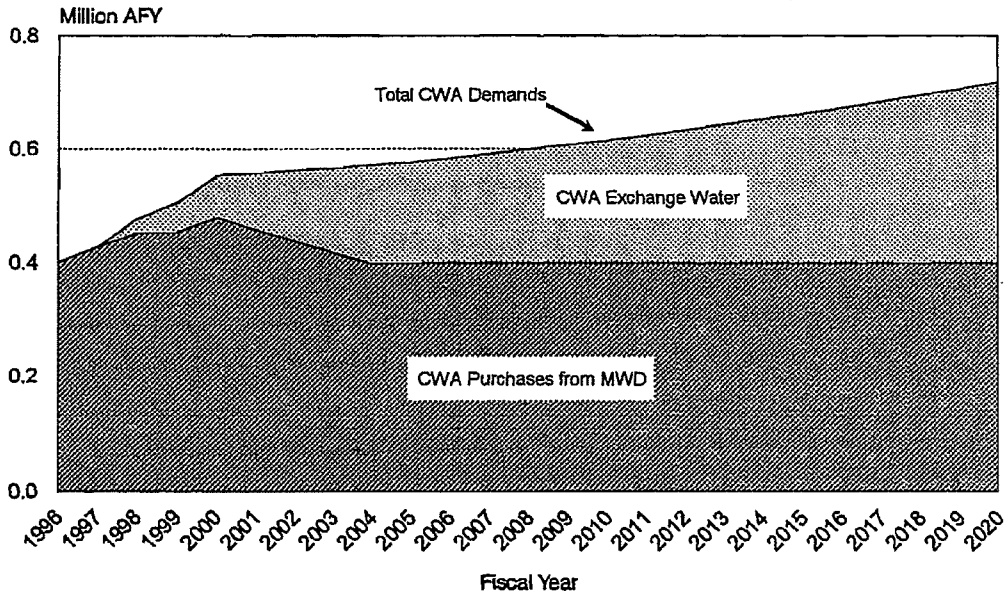
Additional Facilities. MWD and the Authority would consider what additional facilities might be necessary to facilitate deliveries. MWD would consider providing financial assistance for a transfer facility, and the Authority would consider purchasing a portion of available storage space in Eastside Reservoir.

River Operations. The Authority would support banking and river management outlined in the proposed California position paper.

Dispute Resolution. A dispute resolution process would be established.

Figure 1

Projected CWA Normal Year Demands and Supplies
Under CWA Water Exchange Proposal



Source for Demand Projections: San Diego County Water Authority CWA-MAIN Model.

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4/22/96

DISCUSSION PAPER
PROPOSAL FOR SERVICE CONTRACT BETWEEN THE SAN DIEGO COUNTY WATER AUTHORITY (SDCWA) AND THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA (MWD)

APRIL 22, 1996

This paper addresses certain issues regarding SDCWA's proposal that it enter into a service contract with MWD for the purchase and delivery of water. The proposal would commit SDCWA to purchase water from MWD at the level of at least 400,000 AF per year, as part of a restructuring of MWD's financial operations in order to enable MWD to proceed with its Capital Improvement Program (CIP) as modified to reflect more accurately the demands on its system. The proposal would also enable SDCWA to obtain water from sources other than MWD in order to enhance its capacity to serve the growing demands of its own members more reliably.

Under SDCWA's proposal, MWD would determine in its own discretion the manner in which it would satisfy its commitment to deliver water to SDCWA; no part of any MWD facility would be dedicated to SDCWA. Furthermore, the proposal is based on a financial plan that would enable MWD to offset all its fixed costs through charges for its member agencies' purchases of MWD water; consequently, no shifting of costs would occur to other MWD member agencies if MWD delivers water to SDCWA (or to others) at variable cost. Finally, SDCWA would obtain no preferential advantage. The agreement would have the effect of negating the potentially adverse effect upon

SDCWA of preferential rights rules. Beyond that objective, however, SDCWA neither seeks nor would secure any advantage over MWD's other member agencies with regard to its treatment in times of shortage, or respecting its entitlement to MWD water or services.

- Take or Pay Commitment. At the heart of CWA's proposal is its willingness to commit to an Annual Requirement at least equal to its current use of about 400,000 AF. SDCWA believes it is in the interests of MWD and all its member agencies that MWD obtain such commitments from all its customers so that it can plan realistically. At the same time, SDCWA is prepared to support the right of member agencies to purchase water from MWD in any given year beyond their annual commitments. The price charged for such water, however, should reflect the cost imposed on MWD by the uncertainty generated by this practice. A premium charged for such water will tend, moreover, to encourage customers to make annual commitments that cover their full need for MWD water. SDCWA believes that MWD should cover all its fixed costs from income derived from its charge for Annual Requirement and Premium Water. If MWD is unable to secure the agreement of its member agencies to this policy, SDCWA is prepared to discuss alternatives designed to cover all MWD's costs on a basis related to actual demand.

- Alleged Dedication of MWD Facilities. SDCWA seeks no commitment from MWD to dedicate to SDCWA's use or service any part of any MWD facility. Under the

proposed contract, SDCWA will make available to MWD agreed amounts of water, which SDCWA purchases from other sources and will, thereafter, call upon MWD for delivery of equivalent amounts of water on agreed terms and conditions. MWD will assume full control over the water made available to MWD by SDCWA and will deliver to SDCWA water from such sources and through such parts of its system as MWD sees fit to utilize. SDCWA will pay MWD's actual costs for the delivery of water based on the source and method of delivery selected by MWD.

- No Shifting of Cost. The proposal makes clear that SDCWA seeks no shifting of the cost of services obtained from MWD to other member agencies. If MWD succeeds in recouping all its fixed costs from charges for MWD water (Annual Requirement and Premium Water), then charging member agencies the variable cost for delivery of non-MWD water will not result in the shifting of any cost. If MWD fails to convince its member agencies to make the commitments necessary to cover its fixed costs from sales of MWD water, then SDCWA is prepared to consider other rate mechanisms or levels to avoid cost shifting.

- No Preferred Treatment. SDCWA seeks no form of preferred treatment. The proposed agreement would entitle SDCWA to the delivery of Supplement Water regardless of the potentially disadvantageous effect of preferential rights rules. Once the potential effect of such rules has been offset through the delivery of Supplement Water, MWD would have no obligation to deliver such water to

SDCWA if the effect of such delivery would be to treat SDCWA more favorably than any other member agency. If, as some member agencies have suggested, the preferential rights rules are changed to negate the potential disadvantage they impose on SDCWA, the need for Supplement Water would be eliminated. SDCWA would thereupon seek an agreement for the delivery of up to the entire 400,000 AF per year on a space-available basis. Until such a change is made effective, however, Supplement Water will serve an essential purpose. Nor does SDCWA seek a preferred position with regard to use of the space available in the MWD system for delivery of non-MWD water. SDCWA recommends that the space available in the MWD system should be allocated (by relevant category) to its member agencies on the basis of the proportion of total Annual Requirement commitments made by each of them. Thus, if SDCWA commits to one-fourth of MWD's unused capacity, this method of allocating available space would encourage member agencies to make Annual Requirement commitments at the level of their full, anticipated needs.

- Shortage Sharing. SDCWA's proposal would provide additional protection to MWD member agencies. The water made available to MWD by SDCWA would, beyond offsetting the preferential rights disadvantage, be available to MWD for distribution in a shortage to all MWD members. Significantly, to the extent the water made available to MWD is Colorado River water, it would also be free of all claims by

agencies with higher priorities than MWD, if the current negotiation reaches a successful conclusion.

- Claimed Lack of Aqueduct Space. SDCWA believes that MWD cannot be certain that its Colorado Aqueduct will be full for the next 25 years. Even if California is able to secure banking and river operation rules that increase available supplies, competing demands, especially by Arizona, are a factor that MWD's estimates have not taken into account. Furthermore, the long-run prospects for Colorado River demands are such that MWD must anticipate being deprived of current and anticipated surpluses. A full aqueduct is no advantage, moreover, if carrying such amounts is unnecessary. New demand forecasts are running at 10% below the IRP. MWD's interest (i.e., the regional interest) in utilizing the maximum possible amount of Colorado River water is, in any event, satisfied by permitting SDCWA to purchase amounts that are conserved in order to deliver such amounts to MWD for use in its system. Any extra cost that is paid for such water, above the cost to MWD of surplus Colorado River water, would be paid by SDCWA, not MWD. It would be inappropriate for MWD to insist that SDCWA purchase such water only from MWD, particularly since SDCWA prefers to have the option of purchasing such water from other sources.

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Regional Benefits of San Diego County Water Authority Water Exchange Proposal

The San Diego County Water Authority's water exchange proposal would provide significant immediate and long-term benefits to Metropolitan and its member agencies. In the near-term, the Authority's water exchange proposal would eliminate the need for the All-American Canal Lining Project, for an immediate savings of $120 million. Over the longer term, the Authority's water exchange proposal would reduce or eliminate Metropolitan expenditures for additional Colorado River supplies. Depending on the availability of alternative supplies, the present value of avoided supply costs through 2020 could be as high as $340 million. The present value of avoided costs over the period 2021 through 2050 would be even higher, ranging from $400 to $500 million.[1]

The construction of a separate San Diego conveyance facility, should such a facility prove economically and technically feasible, could permit Metropolitan to downsize, defer, or cancel projects in the current Capital Improvement Program, such as Pipeline 6 ($324 million) and the Perris Filtration Plant ($403 million). The construction of a conveyance facility could also allow Metropolitan to defer several projects being considered for inclusion in the Capital Improvement Program (e.g., the Desalination Demonstration Project and Skinner Filtration Plant Module 7).

Potential Deferred or Avoided Costs

Capital Facilities:	$120 to $947 million
Additional Supplies:	
1999 - 2020	$ 0 to $340 million
2021 - 2050	$400 to $500 million

The Authority's water exchange proposal would also significantly increase the long-term reliability of regional water supplies. Many uncertainties exist which will affect Metropolitan's access to Colorado River supplies. The state of Arizona is proposing to increase diversions of its entitlement by up to 400,000 acre-feet per year. River hydrology is variable and long dry cycles are documented.

To increase the reliability of Colorado River supplies, Metropolitan is pursuing reservoir re-operation, such as that proposed under Reliability Plus. However, even if all parties on the River agree to the reservoir re-operation Metropolitan supports, many scenarios exist in which Metropolitan will experience supply shortages between 2010 and 2015. Without reservoir re-operation, shortages could occur earlier. With re-operation, and if the Colorado River Basin were in a wet period and Arizona's plans did

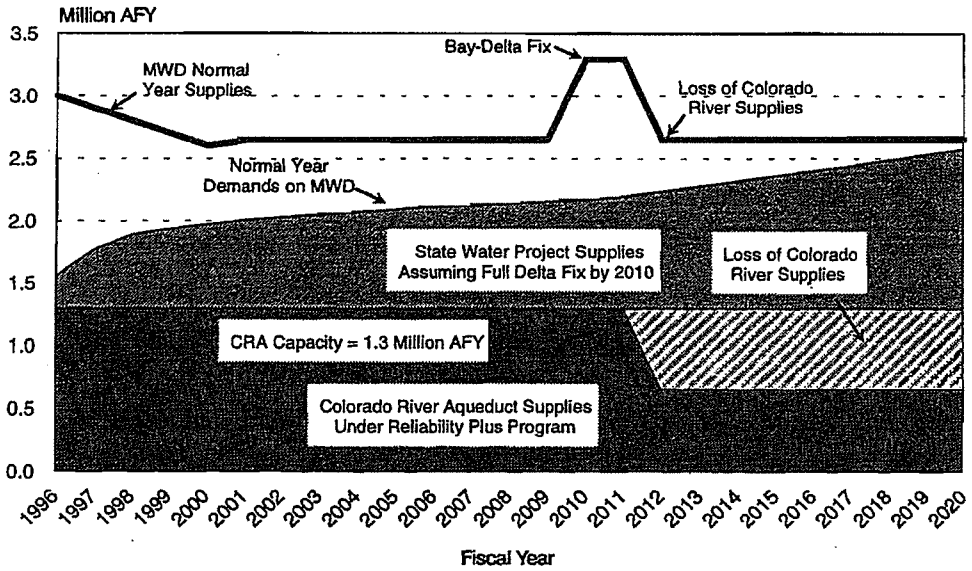
[1] The present value analysis assumes Colorado River supply shortages could develop between 2000 and 2025. Alternative supplies are assumed to cost $150 per acre-foot in current dollars. The analysis assumes an inflation factor of 3%, a discount factor of 6%, and excludes benefits associated with the first 68,000 acre-feet of yield (the estimated yield of the All-American Canal Lining Project).

not materialize, shortages may not occur until later. Figures 1 and 2 below assume what many believe to be a likely scenario.

Figure 1 shows Metropolitan's normal year supplies and demands, where supplies are defined as normal-year Colorado River and State Water Project supplies. As shown in Figure 1, the benefits of a Bay-Delta "fix" could be largely offset by a loss of Colorado River supplies after 2010. Metropolitan would eventually have to seek additional supplies just to meet projected normal year demands.

Figure 1

MWD Reliability Plus Program

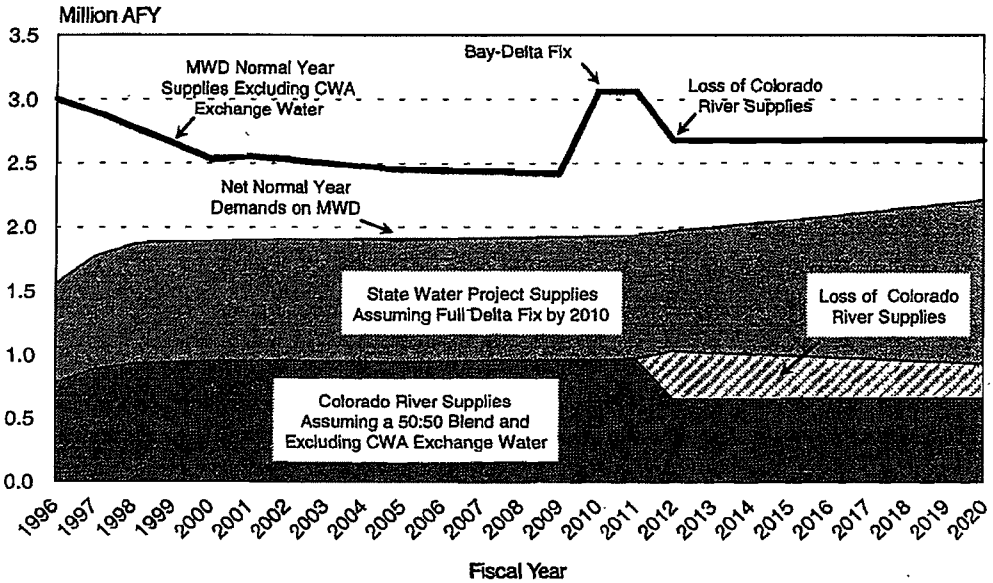


Source for Demand Projections: Revised IRP Forecast of Normal Weather Expected Member Agency Demands. Graph assumes water banked under Reliability Plus Program is fully utilized by 2012 (per Reliability Plus document, page 12).

The Authority's proposed water exchange would offset a large portion of the projected shortfall in Colorado River supplies and provide an added increment of reliability if additional supplies are not developed as anticipated in Metropolitan's Integrated Resources Plan. Figure 2 assumes a 50:50 blend of Colorado River and State Project water; however, similar results would be seen under a 60:40 blend scenario.

Figure 2

CWA Water Exchange Proposal



Source for Demand Projections: Revised IRP Forecast of Normal Weather Expected Agency Demands. Graph assumes water banked under Reliability Plus Program is fully utilized by 2012 (per Reliability Plus document, page 12).

Colorado River Issues and Solutions

THE SAN DIEGO COUNTY WATER AUTHORITY'S PERSPECTIVE

INTRODUCTION

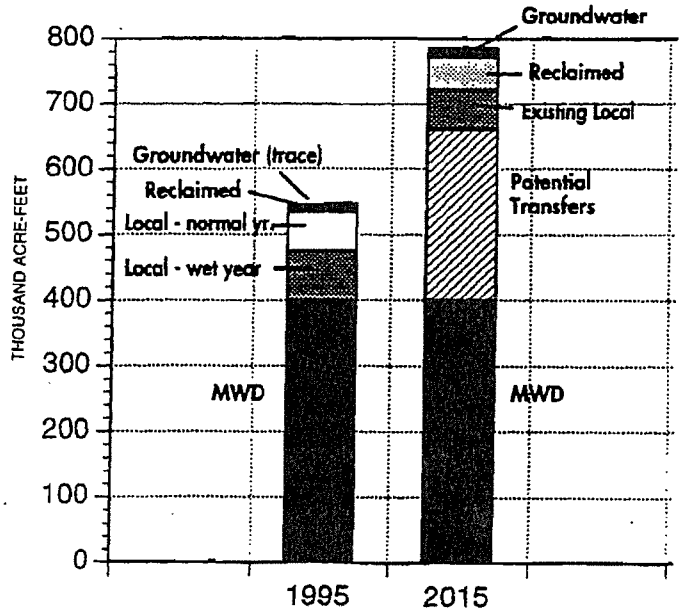
The San Diego County Water Authority has analyzed the Metropolitan Water District (MWD) proposal regarding Colorado River supplies and believes that the program may have some benefits for the region, but only in the short term. The Authority has designed an alternate plan, which will increase the quantity and reliability of the region's firm Colorado River supplies in the immediate future and the long run. The Authority proposal also will reduce the cost to MWD member agencies for development of new supplies and capital improvements. The plan will accomplish these goals within existing priorities on the River and use Southern California's water to solve a major Southern California water supply problem.

This fact sheet presents the Authority's plan, which includes proposed long-term water transfer agreement between the Authority and the Imperial Irrigation District (IID). It then examines Southern California's situation regarding Colorado River supplies and proposals to make those supplies more reliable.

Sources of San Diego County Water Supply

1995 total demand: 560,000 acre-feet, including 7,000 acre-feet resulting from conservation

2015 total demand: 786,000 acre-feet, including 80,000 acre-feet resulting from conservation



THE SAN DIEGO COUNTY WATER AUTHORITY'S PLAN

Briefly summarized, the Authority's plan would:

- Commit the Authority to purchase a large portion of its future supplies from MWD to financially support MWD's operating budget and current Capital Improvement Program.
- Allow the Authority to use capacity in the MWD system to deliver water purchased by the Authority from others, including IID. A portion of this capacity would be available as space permits.
- Reduce MWD's Capital Improvement Program commensurate with member agencies' commitments to purchase future supplies.
- Recognize the regional benefits of agricultural water sales through continuation of MWD's program to provide a water rate discount commensurate with these benefits.
- Improve water quality through MWD's commitment to provide a blend of water supplies in accordance with Section 136 of the MWD Act.
- Provide more reliable Colorado River supplies through water transfers.

The Authority plan would bring additional firm Colorado River entitlements to urban Southern California. It would make existing Colorado River supplies more reliable in the short term and increase supplies available from the River far into the next century. Moreover, this water would be highly reliable because of IID's senior entitlement rights.

The Authority has begun negotiations with IID to fund agricultural water conservation projects and transfer the conserved water to the Authority. The Authority's goal is to acquire up to 400,000 acre-feet of water annually for at least 50 to 100 years at a price comparable to that of other reliable sources.

Continued on next page

Transfer water from IID would augment San Diego County's supply from MWD; the Authority would remain an MWD member agency and commit to purchase a significant amount of water from MWD every year. This commitment would help to ensure MWD's fiscal stability.

The transfer water from IID either would be wheeled through the Colorado River Aqueduct or delivered through a new facility constructed by the Authority.

A water transfer agreement with IID would help San Diego County to:

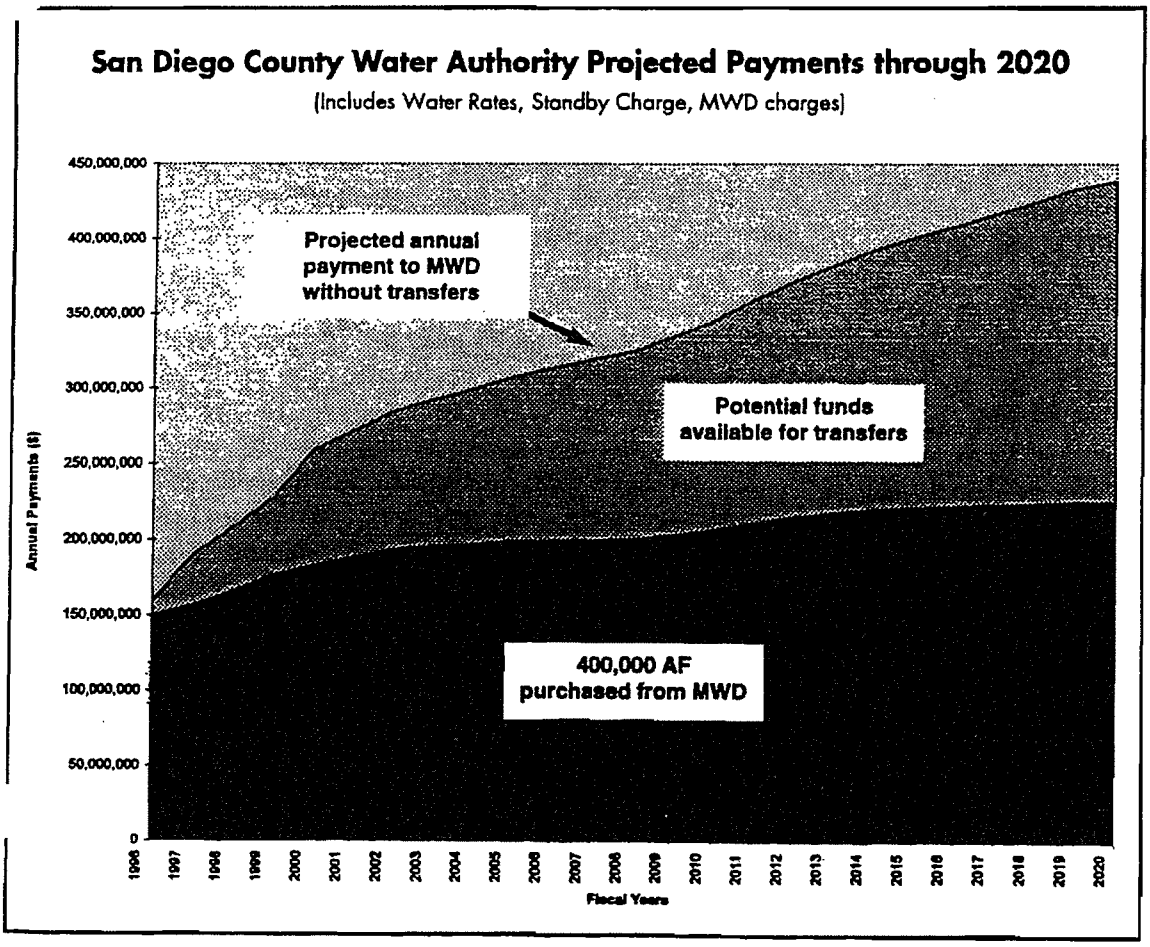
- Maintain an adequate, reliable water supply, which in turn helps sustain the county's economy, protects jobs and maintains a high quality of life.
- Obtain an "insurance policy" against the impact of water shortages in times of drought.
- Provide a degree of independence that would allow the San Diego region to control a significant portion of its own destiny as far as water is concerned.

BENEFITS TO SOUTHERN CALIFORNIA

The Authority plan would benefit MWD's service area by reducing the growing demand on the MWD's limited water resources. The proposal is consistent with MWD's Integrated Resources Plan, which encourages the district's member agencies to develop additional water supplies, and thus make the regional water supply more reliable.

The Authority proposal would:

- Provide the region with more reliable water supplies.
- Allow MWD member agencies to avoid investing between $350 million and $1 billion (today's dollars) in projects that the district estimates are necessary to keep the Colorado River Aqueduct full.
- Provide MWD with more certain revenue sources through a firm commitment by the Authority to purchase the district's water.



BENEFITS TO CALIFORNIA

The Authority plan also would serve California as a whole by providing a Southern California solution to a Southern California water supply problem, which in turn could reduce demands on the State Water Project and help relieve pressure on the Bay-Delta. The plan also would help make agricultural water use more efficient.

TIMEFRAME

Because of the long lead time required to put a major water transfer agreement into effect, the future is now for the Authority and IID. Imperial Valley farmers and IID itself will need up to 20 years to fully implement conservation programs necessary to save 400,000 acre-feet of water annually and make it available to San Diego County. Moreover, before conservation itself may occur, the involved agencies must rigorously review all potential consequences of a transfer agreement.

Meanwhile, the potential for water shortages looms in the near future, as documented by the State Water Plan.

MWD'S PROGRAM

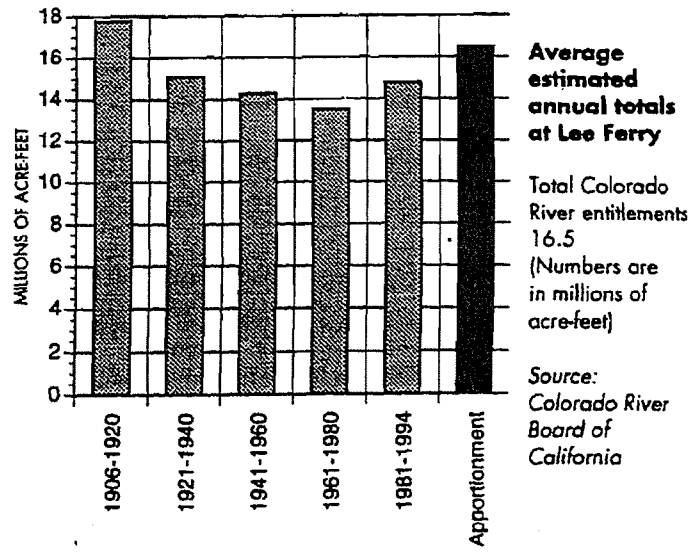
MWD's Colorado River Reliability Plus Program called for:

- Enabling MWD to bank water saved through conservation measures already in place, potential additional conservation measures and deliveries not taken by MWD to control salinity levels in its distribution system.
- Providing 30,000 acre-feet per year of MWD entitlement water to Nevada.
- Lining the All-American Canal and banking the saved water.
- Storing water in Arizona groundwater basins through 2000.
- Implementing revised Colorado River reservoir operating criteria to allow a greater drawdown of storage reservoirs.

OVERALLOCATIONS AND FUTURE SHORTAGES

The 1922 Colorado River Compact resulted in annual apportionments of 7.5 million acre-feet of Colorado River water to the Upper Basin and 7.5 million acre-feet to the Lower Basin. A 1944 treaty obligated the United States to deliver 1.5 million acre-feet per year to Mexico. When the Compact was being negotiated, the Colorado River's estimated annual natural flow averaged 18.1 million acre-feet at Lee Ferry. Contrasting this hydrology with the estimated natural flow of 15 million acre-feet per year between 1906 and 1994 suggests that the Compact was negotiated during a period of abnormally high flows and that the Colorado River is overapportioned. Since 1951, the average annual flow is 13.9 million acre-feet.

Colorado River flows and entitlements



The disparity between natural flows and apportionments concerns the Lower Basin states in particular. California uses all of its annual apportionment, plus surplus water and apportioned water unused by other states. MWD relies on surplus and unused water for more than half of its Colorado River Aqueduct deliveries. Nevada will fully use its Colorado River apportionment within the next 10 to 15 years. Arizona jealously guards its apportionment for long-term use and is developing a plan to substantially increase its use of River water in the near future.

Given this situation, MWD projects it may not receive all the water it needs from the Colorado River by as early as 1999 and in any case no later than the 2020s.

SHORT-TERM RELIABILITY

MWD's proposal is designed to make its Colorado River supplies more reliable into the early years of the 21st century. MWD acknowledges that beyond the next 20 years its supplies could become less reliable, but contends that it can act in the future to secure additional water.

However, it takes time to develop the necessary quantities of additional supplies through implementation of conservation measures. An agency pursuing such a course must act now to make sure such water is available 20 or more years in the future.

Continued on back page

REACTIONS TO MWD'S PROPOSAL

The Authority believes the MWD proposal may not achieve the district's stated goals and also faces a number of hurdles. MWD's proposal to bank what are in essence surplus supplies has not been well received by those that are using less than their apportionment. In the face of this opposition, MWD announced on March 19 that it had withdrawn its plan to provide 30,000 acre-feet of MWD entitlement water to Nevada. In addition, objections from throughout California make MWD's proposal to line the All-American Canal and bank the saved water unlikely to occur.

MWD's proposal does not include banking for others. It is more likely that all River users would be allowed to bank supplies under certain circumstances. The benefits of banking, if any, to MWD could depend on how much water other parties are allowed to bank. MWD is the primary user of surplus water now. Any water conserved by MWD already accumulates in Lake Mead and is available as a part of the surplus supply. Water banking by other parties could actually decrease the availability of these surplus supplies.

As for MWD's recommendation to change River operations, the Bureau's reservoir studies indicate this may result in increased surplus deliveries in the next 15 to 20 years. However, it also increases the risk of shortages. In the long term, there would be an increasing probability that Arizona would be adversely affected and no surplus supplies would be available for MWD. The Bureau may even declare shortages on the River.

MWD's program must have the support of the other Colorado River contractors in California, as well as Arizona and Nevada. In a November 28, 1995 letter, the Imperial Irrigation District, Coachella Valley Water District and Palo Verde Irrigation District stated their opposition to unilateral MWD actions that may jeopardize existing rights to River water.

Arizona objects to any proposal that will increase its risk of shortages, according to the Arizona Department of Water Resource's November 1995 paper, "Colorado River Issues: The Arizona Perspective." The paper also states that Arizona only supports banking that occurs off the mainstream River.

Should MWD proceed with its proposal, it may well face a protracted legal struggle. "History demonstrates that Arizona will take whatever actions that are necessary to protect its entitlement to Colorado River water," Arizona Governor Fife Symington wrote in a November 22, 1995 letter to Bruce Babbitt, Secretary of the Interior.

Moreover, the proposal requires approval from both the federal and California state governments. Opponents would attempt to stall any MWD action in Congress and the California Legislature.

Even if MWD overcomes these obstacles and puts its proposal into effect, the program does not go far enough in meeting urban Southern California's projected water needs. As already noted, MWD says the program aims to alleviate potential shortages for the next 20 to 30 years. MWD is silent on what will happen after that.

The San Diego County Water Authority believes the region will need other measures of a more long-term nature to provide a sufficient, reliable water supply in the future.

San Diego County Water Authority

3211 Fifth Ave.
San Diego, CA 92103

APRIL 1996

San Diego County Water Authority
A Public Agency
3211 Fifth Avenue • San Diego, California 92103-5718
(619) 682-4100 FAX (619) 297-0511

February 17, 2000

Gilbert F. Ivey
Board Executive Officer
The Metropolitan Water District
of Southern California
700 North Alameda Street
Los Angeles, CA 90054-0153

Via Fax No. 213-217-5704 and Overnight Delivery

Re: Submittal to Strategic Plan Steering Committee and Board of Directors of the Metropolitan Water District of Southern California Regarding the Water Authority's Proposal for a Framework of Key Contract Terms

Dear Mr. Ivey,

Transmitted herewith is the above referenced submittal conforming to the requested by Larry Kosmont, Chair of Metropolitan's Strategic Plan Steering Committee in his memorandum to Member Agency Manager dated February 3, 2000.

In order to assure receipt by your office today, the original is being transmitted by facsimile and is also being sent by overnight delivery.

Very truly yours,

Daniel S. Hentschke
General Counsel

cc: San Diego County Water Authority
Board of Directors

Maureen A. Stapleton, General Manager

San Diego County Water Authority
A Public Agency
3211 Fifth Avenue • San Diego, California 92103-5718
(619) 682-4100 FAX (619) 297-0511

SAN DIEGO COUNTY WATER AUTHORITY

SUBMITTAL TO STRATEGIC PLAN STEERING COMMITTEE AND BOARD OF DIRECTORS OF THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA REGARDING THE WATER AUTHORITY'S PROPOSAL FOR A FRAMEWORK OF KEY CONTRACT TERMS

FEBRUARY 17, 2000

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Table of Attachments

I.

EXECUTIVE SUMMARY

The basic premise of the San Diego County Water Authority's Framework of Key Contract Terms ("Framework") is that each member agency and Metropolitan will specify by contract the water and services Metropolitan will provide and a formula by which the member agency agrees to pay for the water and services. The formula would establish a direct connection between the costs of facilities, supplies and programs and the benefits of such facilities, supplies and programs to each member agency. The Framework is grounded on the principle that each member agency should pay the actual cost for service and facilities provided to it by Metropolitan. A copy of the Framework is included in Attachment F to this submittal.

The San Diego County Water Authority agrees with the conclusion by Metropolitan's Board that the status quo may not represent a fair allocation of costs, and further believes that the status quo is not justifiable under objective evaluation criteria.

Metropolitan must address a number of significant policy issues in order to assure its financial integrity and future competitiveness. These issues include, but are not limited to, the preferential rights provision of Section 135 of the Metropolitan Water District Act and the economic consequences of having built conveyance, distribution and treatment facilities sized to meet peak demands of member agencies that use and pay for the facilities only on a periodic or irregular basis. Other policy issues are listed in Section III of this submittal.

Metropolitan's Board of Directors and its Strategic Plan Steering Committee have requested that each submittal contain an analysis of consistency with the Final Draft Strategic Plan Policy Principles adopted on December 14, 1999 and with the Strategic Plan Steering Committee's basic guidelines regarding rate structure principles adopted on January 6, 2000. These analyses are contained in Sections IV and V, respectively of this submittal. The Framework is consistent with the Strategic Plan Policy Principles and with the basic guidelines regarding rate structure principles.

Under the Framework, issues that have caused significant debate, including wheeling, would be resolved because those member agencies that have committed to pay the cost of conveyance facilities would be entitled to use those facilities to transport Metropolitan and non-Metropolitan supplies.

II.

INTRODUCTION

On February 8, 2000, Joseph Parker, Chair of the San Diego County Water Authority ("Water Authority") and one of its representatives on the Metropolitan Board of Directors, presented to Metropolitan a proposed Framework of Key Contract Terms between the Water Authority and Metropolitan ("Framework"). As previously indicated by Dr. Parker, the Framework is intended to serve as the basis of discussion at the Water Authority and Metropolitan. At a special meeting held on February 4, 2000, the Water Authority's Board authorized submission of the Framework for discussion at Metropolitan, subject to further deliberation, refinement and action by the Water Authority Board.

The details of the Water Authority's proposal are set forth in the Framework, which is included in Attachment F. However, the key elements of the Water Authority's proposed Framework are summarized as follows:

1. "Committed demands" as referenced in the Strategic Plan Policy Principles are defined in the Framework as being those demands on Metropolitan for which member agencies are willing to sign take-or-pay contracts.

2. Contracts with Metropolitan and any of its member agencies would be voluntary and legally enforceable; as a contract, neither party would have a unilateral right to terminate the contract or modify its terms.

3. The basic premise of the contract is that each member agency and Metropolitan will specify the water and services Metropolitan will provide and a formula by which the member agency agrees to pay for the water and services. The formula would establish a direct connection between the cost of facilities, supplies and programs and the benefits of such facilities, supplies and programs to each member agency.

4. The Water Authority believes that it is in Metropolitan's financial interest to contract with each of its member agencies; however, the Framework's contract proposal is not contingent upon Metropolitan contracting with any other member agencies. In fact, the Water Authority anticipates that a new structure of rates, fees and charges would govern the cost of water for those agencies that choose, in whole or in part, not to contract for firm supplies.

5. The contract and rate structures would reflect the actual cost and risk associated with meeting certain demands and uncertain demands.

6. The contract proposes to utilize preferential rights as the basis of allocation of proportional rights to supply, conveyance and storage facilities.

7. Conveyance facilities are defined as those upstream of a water treatment facility. Once an agency has contracted to pay for conveyance facilities, it would have the right to use them.

8. The contract proposes that member agencies pay for the treatment and distribution facilities that serve them, and, that they not pay for treatment and distribution facilities that do not serve them. Distribution facilities are defined as those "downstream" of a water treatment facility.

9. The Water Authority supports conservation and local projects. In general, there should be a connection between the cost and benefit to member agencies of local projects; otherwise, they shift costs from some member agencies that do not receive benefit to other member agencies that do receive benefit.

The Water Authority's General Manager, Maureen Stapleton, or her Executive Assistant, Bob Campbell, actively participated in the meetings of Metropolitan's member agency general managers to discuss contract and rate structure options. The issues addressed by the Water Authority's Framework were offered for discussion in that forum. At the same time, many of the issues have substantial policy implications that should be addressed by the legislative body of Metropolitan.

III.

LIST OF POLICY ISSUES

The following are an initial list of policy issues the Water Authority believes must be addressed by Metropolitan's Board of Directors, as a whole in an open meeting, as it considers the various rate structure proposals.

1. Should Section 55 of the Met Act be changed to provide for voting on the basis of a formula other than assessed valuation? Given that Metropolitan collects a miniscule portion of its revenues from property taxes, is voting according to property value a fair basis of voting?

2. Should the Met Act be changed to reflect that Metropolitan is no longer only a "supplemental" supplier of water to all of its member agencies, and that it is, in fact, the primary supplier of water to some member agencies and millions of ratepayers? If so, should the Act as amended reflect the economic realities of supplying the differing needs of base load and cyclical buyers?

3. Should Section 135 of the Met Act be changed? If it is not changed, can Metropolitan sell water free of the claims of preferential rights? Is such a supply reliable to a member agency whose purchases regularly exceed its preferential rights?

4. Should Section 136 of the Met Act be changed? If Metropolitan has the physical ability to comply with Section 136, isn't unreasonable not to do so?

5. Should Metropolitan enter into legally enforceable agreements with its member agencies to pass on the benefits of future investments in the State Water Project? If not, is it reasonable to expect the member agencies to pay for those investments?

6. Is it sound public policy for Metropolitan to spend money on massive capital projects and other programs when member agencies are unwilling to make enforceable commitments to pay for them?

7. If Metropolitan's current policies are achieving its mission to be the low cost supplier of water to Southern California, then why are so many of its member agencies seeking to roll-off the system, many on the stated grounds that Metropolitan water is or will become too expensive?

8. Given the magnitude of its expenditures, is there any legally enforceable method other than take-or-pay contracts that can provide Metropolitan with the certainty it needs to assure its fiscal integrity and stability?

9. Should Metropolitan's rate structure establish a relationship between benefits and costs to each member agency? Should Metropolitan continue to insure member agencies against risk and surcharge other members for that risk? Or, should Metropolitan charge the

actual cost of constructing and holding water and facilities available to meet uncertain demands?

10. Metropolitan has a right to substantial excess capacity in the State Water Project that could be made available to member agencies. Should the right to use that excess capacity to transport non-state water project water be made available to the member agencies that have paid for it through the purchase of Metropolitan water?

11. How should Metropolitan address the economic consequences of conveyance, distribution and treatment facilities that have been sized to meet peak demands of member agencies that use the facilities only on a periodic or irregular basis? Is it legally appropriate to require users having a regular or constant demand to pay for the additional standby capacity provided to meet the peak requirements of periodic users?

IV.

ANALYSIS OF CONSISTENCY WITH FINAL DRAFT STRATEGIC PLAN POLICY PRINCIPLES

Section 25 of the Metropolitan Water District Act (MWD Act) states, "Metropolitan water districts may be organized for the purpose of developing, storing, and distributing water for domestic and municipal purposes and may provide, generate, and deliver electric power within or without the state for the purpose of developing, storing, and distributing water for such district." Metropolitan's Board of Directors has acknowledged this purpose and stated its commitment to providing a high quality, reliable supply of affordable water for the residents in its service area.[1] The Water Authority agrees with this purpose and commitment of Metropolitan. Metropolitan has also acknowledged that it must meet the evolving needs of its member agencies, focusing on needs for flexibility, certainty and public stewardship. Finally, the Metropolitan Board has identified seven "common interests that form the basic elements of Metropolitan's strategic plan," reserving issues related to cost allocation and rate structure for future discussion and resolution as set forth in the document titled "next Steps in the Strategic Planning Process" adopted on December 14, 1999, concurrently with the Final Draft Strategic Plan Policy Principles.

The Water Authority has developed a proposal that addresses each of these need categories (identified by Metropolitan as flexibility, certainty and public stewardship) in a productive and practical manner, particularly in the context of the emerging competitive water market. The following is an analysis of how the Water Authority's proposal for a Framework of Key Contract Terms furthers each of the common interests.

Statement of Common Interest

> *Regional Provider. Metropolitan is a regional provider of water for its service area. In this capacity, Metropolitan is the steward of regional infrastructure and the regional planner responsible for drought management and the coordination of supply and facility investments. Regional water services should be provided to meet the need of the member agencies. Accordingly, the equitable allocation of water supplies during droughts will be based on water needs and adhere to the principles established by the Water Surplus and Drought Management Plan.*

Discussion

The Water Authority agrees that Metropolitan is a regional supplier of water for the Metropolitan service area, including the Water Authority. However, there is not a uniform customer profile among Metropolitan's member agencies. Some of Metropolitan's members have little or no local water resources and depend heavily on imported water. Other members have significant local water resources, particularly groundwater, and rely upon Metropolitan regularly to supplement these water resources. Still others rely on Metropolitan only periodically to supplement the members' other local or imported water supplies. Consequently, Metropolitan

[1] Final Draft Strategic Plan Policy Principles, December 14, 1999, Preamble.

provides different supply services to it members depending upon their specific needs. For some it provides regular supply service, for others it provides seasonal supply service and for still others it provides standby supplemental service. The Water Authority's proposal recognizes that in order for Metropolitan to be competitive, it must tailor its services to meet different needs of its various members and price those services at a competitive cost that covers the actual costs of each service. The Water Authority's proposal would allocate the costs of providing these different services so that each member is paying the costs of the service it is receiving.

The Water Authority agrees that Metropolitan is a steward of regional infrastructure. Metropolitan should not be a steward of infrastructure that does not service regional needs. Metropolitan's diverse infrastructure does not provide the same benefit or service to each member agency. The Water Authority's proposal acknowledges the functional distinction among the various components of Metropolitan's infrastructure and distributes costs accordingly. Thus, the costs associated with conveyance facilities (generally the aqueducts and other water transmission facilities located "upstream" of an MWD water treatment facility, or the nearest treatment facility in the case of untreated water service) would be distributed among all member agencies. As a corollary, costs associated with distribution facilities would be distributed among the members served by the facilities. New facilities would be built based upon specific expressions of need and commitment to pay by each of the various agencies served by the facility.

The Water Authority agrees that regional water services of Metropolitan should be provided to meet the self-determined needs of the member agencies. Metropolitan should start the process of establishing those needs by asking each member agency to state its requirements for service from Metropolitan and, thereafter, obtain the agreement of each member agency to pay for those services. The Water Authority has presented a proposal that, subject to further refinement and negotiation over precise terms, states the Water Authority's service requirements and the contract terms is willing to consider.[2] The Water Authority would consider contracting for additional firm supplies if claims of statutory preferential rights were eliminated. The Water Authority is prepared to pay for its firm supply of water based upon actual cost of providing that water.

The Framework contemplates that the Water Surplus and Drought Management Plan would recognize need as established by contracts with member agencies, along with the contracted priority of commitments. Under the Framework, the Water Surplus and Drought Management Plan would continue to apply to all "non-contract" water. Allocation of that water during a drought would continue to be within the discretion of Metropolitan. The Water Authority's Framework acknowledges the existence of preferential rights and the impact of those rights on Metropolitan's supply.

Statement of Common Interest

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[2] The Water Authority's proposal is based upon Metropolitan's present ability to deliver under the statutory constraint of preferential rights. As stated it its Framework of Key Contract Terms, the "Water Authority is prepared to accept limitations on firm contract supply according to preferential rights so long as financial obligations are also contractually apportioned accordingly and accepted by the MWD member agencies that claim those rights."

Financial Integrity. The Metropolitan Water District Board will take all necessary steps to assure the financial integrity of the agency in all aspects of its operations.

Discussion

The Water Authority believes that Metropolitan's financial integrity is in jeopardy under the current rate model and financial plan. Metropolitan's current rate structure and operating methods encourage its members to seek alternatives to purchasing Metropolitan services and supplies. Contracts as proposed by the Water Authority would provide Metropolitan with the financial certainty it needs while providing its member agencies with the assurance that costs will be fairly borne by all members.

The Framework suggests long term enforceable contracts covering (a) a contract right to a minimum share of firm supply offered according to preferential rights, (b) a contract obligation to bear financial liability directly associated with those contract rights, and (c) a right to use specified conveyance facilities based upon a proportional allocation of MWD's full conveyance capacity." New projects would be funded based upon contracts to pay for the services, facilities or supplies between Metropolitan and those member agencies desiring those projects. The Water Authority's proposal acknowledges the differences in consumer characteristics and requirements of Metropolitan's various members and establishes a method by which each can choose to acquire and pay for the services and supplies that fit those characteristics and requirements.

Establishing a nexus between the price paid and the services received by is member agencies should enhance Metropolitan's financial integrity. Given the differing requirements of its members, the characteristics of its facilities and supplies, and its large amount of fixed costs, Metropolitan must take action to eliminate its reliance on a volatile, volumetric rate structure.

Statement of Common Interest

Local Resources Development. Metropolitan supports local resources development in partnership with its member agencies and by providing its member agencies with financial incentives for conservation and local projects.

Discussion

Local resource development has two distinctly different components. One component is comprised of water conservation programs to reduce water demand. The other component is comprised of local water *supply* projects including wastewater reclamation, groundwater recovery, desalination and other similar supply projects.

The Water Authority strongly supports water conservation to reduce water demand. The Water Authority would support action by Metropolitan requiring its member agencies to be in compliance with the Memorandum of Understanding Regarding Urban Water Conservation in California as it pertains to implementation of Best Management Practices for water conservation. Metropolitan's water conservation programs should be funded and administered in a non-discriminatory manner in which the costs and benefits of such programs are recognized.

Local water supply projects provide direct benefit to local agencies. The Water Authority proposes that future projects be funded by contract. Costs for projects in existence on January 1, 2000 could be funded by a non-discriminatory surcharge on all member agencies that recognizes the costs and benefits of such programs. Currently, there is little, if any, nexus between the amount paid to Metropolitan to support local resources development programs and the benefits received by Metropolitan's member agencies who are subsidizing those programs.

Statement of Common Interest

> *Imported Water Service, Metropolitan is responsible for providing the region with imported water, meeting the committed demands of its member agencies.*

Discussion

The Water Authority agrees that Metropolitan provides the region with imported water. Metropolitan is not now and never has been the sole importer of water into the region. The Water Authority's proposal acknowledges Metropolitan's firm supplies are approximately 2.11 million acre-feet/year of water. Its proposal also acknowledges that Metropolitan has existing facility capacity well in excess of the amount of the firm supply. Under the Authority's proposal, Metropolitan would seek out and secure additional water supplies only upon a committed demand from one or more member agencies as demonstrated by a contract to pay for such additional supplies. Wheeling disputes among member agencies that enter into water contracts with Metropolitan would no longer exist, because each contracting agency would have the right to use its contract capacity to transport non-Metropolitan water if it chose to do so.

Statement of Common Interest

> *Choice and Competition. Beyond the committed demands, the member agencies may choose the most cost-effective additional supplies from either Metropolitan, local resources development and/or market transfers. These additional supplies can be developed through a collaborative process between Metropolitan and the member agencies, effectively balancing local, imported, and market opportunities with affordability.*

Discussion

The Water Authority's proposal contemplates that Metropolitan will acknowledge the actual costs of facilities and services that each member agency desires from Metropolitan and charge accordingly. This, coupled with other changes such as the elimination of preferential rights, will allow Metropolitan to become competitive with alternative suppliers. The collaborative process in which additional supplies are developed will become more meaningful and cost-effective as member agencies accept financial responsibility for their own demand projections and resource planning to meet those needs.

Statement of Common Interest

> *Responsibility for Water Quality. Metropolitan is responsible for advocating source water quality and implementing in-basin water quality for imported supplies provided by Metropolitan to assure full compliance with existing and future primary drinking water standards and to meet the water quality requirements for water recycling and groundwater replenishment.*

Discussion

This statement has two different components. The first component contemplates advocacy by Metropolitan to assure source water quality. The Water Authority fully supports this statement. Under the Water Authority's proposal costs associated with assuring source water quality would be included within the full cost of providing that supply.[3] The second component contemplates treatment of imported supplies and implementation of other programs to meet water quality requirements.

Metropolitan's treatment facilities are an example of facilities that do not provide regional service.[4] Consistent with its proposal for allocating costs for conveyance and distribution facilities, the Framework suggests that the Water Authority would accept financial responsibility for the Skinner Filtration Plant subject to an appropriate share of the expenses being borne by the other users. The Water Authority would no longer pay for treatment and distribution facilities that do not serve the Water Authority.

Statement of Common Interest

> *Cost Allocation and Rate Structure. The fair allocation of costs and financial commitments for Metropolitan's current and future investments in supplies and infrastructure may not be reflected in status quo conditions and will be addressed in a revised rate structure:*
>
> *a) The committed demand, met by Metropolitan's imported supply and local resource program, has yet to be determined.*
>
> *b) The framework for a revised rate structure will be established to address allocation of costs, financial commitment, unbundling of service, and fair compensation for services including wheeling, peaking, growth and others.*

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[3] As noted in the Framework, the Water Authority expects to receive a blend of water proportionate to Metropolitan's annual supply from its two primary sources, the State Water Project and the Colorado River.

[4] Costs of Metropolitan's water treatment are presently collected as a surcharge on treated water delivery. The amount of the surcharge is apportioned uniformly to all treated water users. This method of spreading costs ignores both the non-regional nature of the treatment plants and also the fact that Metropolitan has spent hundreds of millions of dollars to provide standby treatment capacity and service to member agencies that purchase and pay for this capacity and service only periodically.

Discussion

The Water Authority believes that the status quo does not represent a fair allocation of costs and that Metropolitan must address the issues raised in the statement of common interest. It appears that there may be very few member agencies that are willing to sign up and pay for Metropolitan's conveyance and distribution system, and other facilities. This poses a threat to the economic well being of Southern California.[5]

[5] A fundamental problem facing Metropolitan is that is has substantial fixed costs, including substantial debt service obligations, but disproportionately insubstantial fixed revenues. Metropolitan's predominant reliance on volatile, volumetric water rates encourages its member agencies to seek a variety of methods to avoid purchases of Metropolitan water. In addition, Metropolitan has developed substantial supply and conveyance potential (including a significant investment in the Diamond Valley Lake) to meet peak and dry year demands, but finances the cost associated with those facilities and supplies primarily from revenues derived from the sale of water during wet and normal years.

V.

ANALYSIS OF CONSISTENCY WITH STRATEGIC PLAN STEERING COMMITTEE BASIC GUIDELINES REGARDING RATE STRUCTURE PRINCIPLES

Basic Guideline

Dry year allocation should be based on need.

Discussion

The principle of dry year allocation based upon need is inconsistent with the principle of preferential rights to purchase water. It is also inconsistent with the principle of providing benefit to each member agency according to the agency's payments. The Water Authority's proposal recognizes this statutory constraint on Metropolitan's ability to supply water. It also assures that member agencies will receive benefits according to their payments. Member agencies that have a potential need for supplies in dry years, but are otherwise irregular or periodic users of Metropolitan water, should pay regularly for the costs attributable to their share of costs for Metropolitan to develop and maintain standby capacity and supply. The Water Authority's Framework would first determine need according to contractual commitments.

Basic Guideline

Rate structure should not place any class of people in the position of significant economic disadvantage.

Discussion

No member agency would be in a position of economic disadvantage if a direct connection were established between the benefits and costs of the programs, facilities, supplies and services Metropolitan actually provides to each of its members. The status quo rate structure, which lacks such a connection, violates this guideline.

Basic Guideline

Rate structure should be reasonably simple and easy to understand.

Discussion

The concept of payment according to a reasonable and direct nexus to benefits is a reasonably simple and understandable basis for a rate structure.

Basic Guideline

Rate structure should be fair.

Discussion

Agreed, however, fairness and equity are not solely in the eye of the beholder. Objective criteria for evaluation of fairness and equity may include: (1) charges should not exceed the cost of providing the service or facility; (2) revenues derived from a customer should not exceed the proportional cost of providing service to the customer; and (3) customers that benefit from standby capacity or supply should pay for them. Clearly articulated standards, consistent with legal requirements, should be applied.

Basic Guideline

Rate structure should be based on stability of Metropolitan's revenues and coverage of its costs.

Discussion

The Water Authority agrees that coverage of Metropolitan's costs is essential. A fundamental deficiency of the current rate structure is the instability of Metropolitan's revenues due to the heavy reliance on volumetric water sales. The Water Authority's Framework is a contract model that would provide stability and fairly allocate cost coverage.

Basic Guideline

Revenue structure should provide certainty and predictability.

Discussion

The Water Authority has proposed a revenue system that is highly certain and predictable for both Metropolitan and its member agencies, a system based upon legally enforceable contracts.

ATTACHMENT A

SECTION 135
METROPOLITAN WATER DISTRICT ACT
PREFERENTIAL RIGHT TO PURCHASE WATER

Each member public agency shall have a preferential right to purchase from the district for distribution by such agency, or any public utility therein empowered by such agency for the purpose, for domestic and municipal uses within the agency a portion of the water served by the district which shall, from time to time, bear the same ratio to all of the water supply of the district as the total accumulation of amounts paid by such agency to the district on tax assessments and otherwise, excepting purchase of water, toward the capital cost and operating expense of the district's works shall bear to the total payments received by the district on account of tax assessments and otherwise, excepting purchase of water, toward such capital cost and operating expense.

ATTACHMENT B

SECTION 136
METROPOLITAN WATER DISTRICT ACT
SERVICE OF STATE WATER; BLENDING

A district which has a contract with the state for a water supply from the State Water Resources Development System and also has an additional source of water for supplying member public agencies, shall serve as large an area as is determined by the district to be reasonable and practical with water from such system, and where a blend of the waters from such different sources is to be served, it shall be the objective of the district that, to the extent determined by such district to be reasonable and practical, not less than 50 percent of such blended water shall be water from the State Water Resources Development System.

ATTACHMENT C

Strategic Plan Policy Principles

December 14, 1999

Preamble

Metropolitan is a voluntary cooperative of member public agencies created for the purpose of "developing, storing and distributing water." Metropolitan's Board is committed to providing a high quality, reliable supply of affordable water for the residents in its service area.

The strategic planning process was initiated in July 1998 in an effort to address the evolving needs of the member agencies and their retailers to effectively fulfill Metropolitan's mission over the long-term. These diverse needs focus on flexibility, certainty and public stewardship.

> **Flexibility:** There are significant legislative and economic pressures to increase the flexibility and responsiveness of water services to meet changing demands through a competitive water market. Fair compensation for wheeling through Metropolitan's conveyance systems is an essential element of Southern California's developing market.
>
> **Certainty:** Certainty in Metropolitan's supply reliability and cost of service is important to member agencies and retailers, particularly in their efforts to ensure value to their customers.
>
> **Public Stewardship:** Metropolitan and its member agencies must ensure that water is available to meet the needs of the public in a cost-effective and environmentally sound manner.

The Board has been engaged in a strategic planning process for the past year and a half. This process identified areas of common interests that form the basic elements for Metropolitan's strategic plan. Issues related to cost allocation and rate structure require further discussion and resolution.

Statement of Common Interests

- Regional Provider. Metropolitan is a regional provider of water for its service area. In this capacity, Metropolitan is the steward of regional infrastructure and the regional planner responsible for drought management and the coordination of supply and facility investments. Regional water services should be provided to meet the needs of the member agencies. Accordingly, the equitable allocation of water supplies during droughts will be based on water needs and adhere to the principles established by the Water Surplus and Drought Management Plan.

- Financial Integrity. The Metropolitan Water District Board will take all necessary steps to assure the financial integrity of the agency in all aspects of its operations.

- Local Resources Development. Metropolitan supports local resources development in partnership with its member agencies and by providing its member agencies with financial incentives for conservation and local projects.

- Imported Water Service. Metropolitan is responsible for providing the region with imported water, meeting the committed demands of its member agencies.

- Choice and Competition. Beyond the committed demands, the member agencies may choose the most cost-effective additional supplies from either Metropolitan, local resources development and/or market transfers. These additional supplies can be developed through a collaborative process between Metropolitan and the member agencies, effectively balancing local, imported, and market opportunities with affordability.

- Responsibility for Water Quality. Metropolitan is responsible for advocating source water quality and implementing in-basin water quality for imported supplies provided by Metropolitan to assure full compliance with existing and future primary drinking water standards and to meet the water quality requirements for water recycling and groundwater replenishment.

- Cost Allocation and Rate Structure. The fair allocation of costs and financial commitments for Metropolitan's current and future investments in supplies and infrastructure may not be reflected in status quo conditions and will be addressed in a revised rate structure:

    a) The committed demand, met by Metropolitan's imported supply and local resources program, has yet to be determined.

    b) The framework for a revised rate structure will be established to address allocation of costs, financial commitment, unbundling of services, and fair compensation for services including wheeling, peaking, growth, and others.

Next Steps in the Strategic Planning Process

Outstanding Issues To Be Resolved

While the November workshop identified the common interests of the Metropolitan Board of Directors on the strategic plan, outstanding issues that require further discussion and resolution were also highlighted. These outstanding issues included the following:

- The baseline regional demand, which guides Metropolitan's delivery requirements, should be determined. Metropolitan is responsible for providing the region with imported water, meeting this projected baseline demand of its member agencies. Beyond this projected baseline demand, the member agencies may choose the most cost-effective additional supplies from either Metropolitan, local resources development, and/or market transfers.

- The process for selecting the most cost-effective local resources development projects for joint implementation by Metropolitan and its member agencies should be developed.

- A framework should be established to guide the design and implementation of a revised rate structure. The framework should address the following issues.

  - Fair allocation of costs and financial commitments for Metropolitan's current and future investments in imported water supplies, source water quality improvements, in-basin treatment, and infrastructure in consideration of regional water needs, past financial contributions, and other relevant factors;
  - The manner, in which Metropolitan pays for Local Resources Program projects and conservation;
  - Fixed revenues, including growth charges, property taxes, and standby charges;
  - Peaking charges;
  - Commodity rates;
  - Unbundling of services;
  - Fair compensation for replenishment and agricultural water deliveries;
  - Fair compensation for wheeling.

Schedule

In the next three months, the Board will have the opportunities to establish the Strategic Plan policy principles and successfully complete the development phase of the process. The meetings, deliverables and Board items are as follows:

Meeting	Deliverables	Board Items
December 14 Strategic Plan Workshop	Strategic Plan Steering Committee recommendation on policy principles and next steps. Member agency managers' presentation on rate structure framework.	Discussion of recommended policy principles.
December 14 Board Meeting	Strategic Plan Steering transmittal of recommended policy principles and next steps.	Board consideration and action recommended policy principles.
Early January Strategic Plan Steering Committee	Draft of the rate structure framework and guidelines. Preliminary determination of projected baseline demands and selection process for local resources projects.	Committee discussion on draft rate structure framework and guidelines.
January - February Board Meetings	Strategic Plan Steering Committee recommendation on rate structure framework and guidelines, and other outstanding issues.	Board consideration and action on recommended rate structure framework and guidelines.
February – March	Public meetings on proposed policies and guidelines.	Board receives and considers the input from public meetings.
March – April	Strategic Plan Steering Committee recommendation on implementation steps.	Board direction to staff to implement Strategic Plan according to approved principles and guidelines.

As Metropolitan proceeds with development of the Strategic Plan, the relationship between policy and implementation becomes important. The Board is responsible for establishing policy positions and guidelines regarding the responsibilities of Metropolitan as a public agency. The proposed policy principles provide such guidelines. Staff is then responsible for implementing these policies by developing specific programs and procedures, including rate structure development, project selection, and investment strategies for supplies and infrastructure improvements.

ATTACHMENT D

RECEIVED
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GEN MGR

MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Date: February 3, 2000

To: Member Agency Managers

From: Larry J. Kosmont, Chair, Strategic Planning Steering Committee

Subject: Rate Structure Framework Proposals

At yesterday's Joint Meeting of the Strategic Planning Steering Committee and the Member Agency Managers, the Steering Committee affirmed that all proposals be submitted by February 17, 2000. In addition, the Committee requests that each proposal be accompanied by a list of the policy issues raised by the proposal and an analysis of the consistency of the proposal with the Final Draft Strategic Plan Policy Principles previously mailed to you. The Steering Committee further requests that the proposals address the basic guidelines it unanimously adopted at its meeting on January 6, 2000. A copy of the highlights of that meeting is enclosed.

For your information, the Steering Committee also directed the staff to organize the proposals for the Steering Committee's March 6 meeting and also directed that the staff prepare background materials on the topics of peaking and preferential rights. Finally, I am attaching the Schedule and Milestones for the Strategic Planning Process that was affirmed by the Steering Committee

We look forward to receiving your proposals and again thank you for all of your hard work. Please forward your materials to Gilbert F. Ivey. Gilbert can be reached by telephone at (213) 217-6622 or via e-mail at givev@mwd.dst.ca.us.

Larry J. Kosmont

Enclosures (2)

Edms #003868518

Attachment C

Highlights of Comments from January 6, 2000 Strategic Plan Steering Committee Meeting on Conceptual Framework and Principles for Rate Structure Development

Consider the following additions to rate structure principles:

- Dry year allocation should be based on need
- Rate structure should not place any class of people in the position of significant economic disadvantage
- Rate structure should be reasonably simple and easy to understand
- Rate structure should be fair
- Rate structure should be based on stability of Metropolitan's revenue and coverage of its costs
- Rate structure should provide certainty and predictability

Other comments:

- Consider revised decision making process based on super-majority for significant expenditures
- Consider change in terminology from "local" to "regional" when referring to Local Resources Program projects
- Metropolitan needs to recover its investments in Local Resources Program projects
- Consider longer-term contracts than those being discussed in rate structure development (20-30 years); compare and contrast short-term to long-term in the development process
- Rate structure development process should begin with determination of guaranteed income necessary to meet Metropolitan's fixed obligations
- Consider ceiling set at 2.1 million acre-feet of sales above which wheeling can occur
- Identify governance issues in the rate structure

Schedule and Milestones for Strategic Planning Process	
Schedule	**Activities**
February 2	Joint meeting Strategic Plan Steering Committee and Member Agency Managers
February 8	Summary update. Report to Board of Directors. Opportunity for presentation of proposals from Member Agencies and private sector representatives. Board may provide additional direction to staff
February 17	Due date for proposals from Member Agencies and private sector with emphasis on relevance of proposals on Board adopted guiding principles of December 1999
March 6 (week of)	Steering Committee meeting. Member Agencies and private sector representatives present proposals. MWD staff presents analysis of proposals. General Manager provides input into process. Prepare for March workshop.
March 13/14	Facilitated Strategic Plan Workshop
March 15 – April 3	Conduct public workshops
March 20 (week of)	Steering Committee update
April 3 (week of)	Steering Committee update. Preparation for April workshop. Steering Committee may recommend a preferred proposal.
April 10/11	Strategic Plan Workshop. Board may adopt a preferred proposal. Provide direction to staff.
April 25 (tentative)	Special Board meeting to adopt preferred proposal and provide staff with direction.

2000 Milestones.doc
(February 2, 2000)

ATTACHMENT E

San Diego County Water Authority
A Public Agency
3211 Fifth Avenue • San Diego, California 92103-5718
(619) 682-4100 FAX (619) 297-0511

Remarks of Joe Parker, Chairman of the Board
San Diego County Water Authority
at
Metropolitan Water District of Southern California
Board Meeting
February 8, 2000

At last week's Strategic Plan Steering Committee meeting, I informed the Committee that the Water Authority Board of Directors had received from its staff and consultants a proposed Framework of Key Contract Terms between the Water Authority and Metropolitan. The Framework was discussed at our Special Board Workshop last Friday. At that time, the Board authorized staff and me, as the Board's representative, to distribute the Framework, along with a copy of the Workshop Documents that formed the basis of our discussion. We have distributed those documents and you have them before you today.

As indicated at the outset of the Water Authority's Framework, it is not an offer to enter into a contract with Metropolitan; it is a "work in progress," intended to serve as the basis of discussion at both the Water Authority and Metropolitan.

The purpose of the Water Authority's Workshop was to develop a preliminary understanding of the Framework and its essential terms; and, to illustrate how the Framework seeks to address the policy issues and objectives that have been established by the Water Authority's Board of Directors. While it is not our purpose today to make a detailed presentation in regard to those matters – we will do so in accordance with the schedule that has been established by Mr. Kosmont as Chairman of the Strategic Plan Steering Committee – we would like to highlight for the Board today some of the key terms and then, briefly suggest how these provisions incorporate and advance this Board's Strategic Plan Policy Principles adopted last December 14.

The key elements of the Water Authority's proposed Framework are briefly summarized as follows:

1. "Committed demands" as referenced in the Strategic Plan Policy principles are defined in the Framework as being those demands on Metropolitan for which member agencies are willing to sign take-or-pay

contracts.

2. Contracts with Metropolitan and any of its member agencies would be voluntary and legally enforceable; as a contract, neither party would have a unilateral right to terminate the contract or modify its terms.

3. The basic premise of the contract is that Water Authority and Metropolitan will specify the water and services MWD will provide and a formula by which Water Authority agrees to pay for the water and services. The formula would establish a direct connection between the cost of facilities, supplies and programs and the benefits of such facilities, supplies and programs to each member agency.

4. Water Authority believes that it is in Metropolitan's financial interest to contract with each of its member agencies; however, Water Authority's contract proposal is not contingent upon Metropolitan contracting with any other member agencies. In fact, we would anticipate that a structure of rates, fees and charges would remain in place and govern the cost of water for those agencies who choose, in whole or in part, not to contract for firm supplies.

5. The contract and rate structures would reflect the actual cost and risk associated with meeting each member agency's demands.

6. The contract proposes to utilize preferential rights as the basis of allocation of proportional rights to supply, conveyance and storage facilities.

7. Conveyance facilities are defined as those upstream of a water treatment facility. Once an agency has paid the cost of conveyance facilities, it would have the right to use them.

8. The contract proposes that member agencies pay for the treatment and distribution facilities that serve them, and, that they not pay for treatment and distribution facilities that do not serve them. Distribution facilities are defined as those "downstream" of a water treatment facility.

9. The Water Authority supports conservation and local projects. In general, there should be a connection between the cost and benefit to

member agencies of local projects, otherwise, they shift cost from some member agencies to other member agencies.

Mr. Chairman, we believe that the Water Authority Framework suggests a financial model to address the needs of flexibility, certainty, and public stewardship as set forth in Metropolitan's Strategic Plan Policy Principles (all references are to the Strategic Plan Policy Principles dated December 14, 1999). Specifically:

1. Metropolitan would remain a regional provider of water, and would be legally responsible to meet the committed demands of its member agencies (*Imported Water Service*). Beyond the contract water, member agencies would remain free to choose to purchase additional supplies from Metropolitan or other sellers (*Choice and Competition*).

2. Metropolitan would continue to be the steward of the regional conveyance system (*Regional Provider*). It would also facilitate water transfers by allowing those who pay for capacity to have the right to use it (*Choice and Competition*), and, it would ensure that fair compensation is paid for the use of conveyance facilities (*Flexibility and Financial Integrity*).

3. Water quality impacts would be accounted for in the financial relationship between Metropolitan and its member agencies (*Responsibility for Water Quality*).

4. The Framework provides certainty to those Metropolitan member agencies who choose it of knowing how much water Metropolitan has contracted to provide, and at what price (*Certainty*). Metropolitan will be better able to plan and manage its own affairs by knowing member agency choices in advance (*Public Stewardship and Financial Integrity*).

5. The importance of water conservation and local projects is recognized (*Local Resources Development*).

Mr. Chairman, in conclusion, we invite the Board to review the Framework of Key Contract Terms and related Workshop Documents at its leisure. We look forward to providing you with a more detailed presentation at the Workshop later this month. In the meantime, I will be happy to answer your questions.

ATTACHMENT F

San Diego County Water Authority
A Public Agency
3211 Fifth Avenue • San Diego, California 92103-5718
(619) 682-4100 FAX (619) 297-0511

SAN DIEGO COUNTY WATER AUTHORITY
BOARD OF DIRECTORS
SPECIAL MEETING
FEBRUARY 4, 2000

WORKSHOP DOCUMENTS

1. Discussion Points
2. Draft Framework of Key Contract Terms
3. Excerpt from *The Governance of the Metropolitan Water District of Southern California: An Overview of the Issues*
4. Diagram of Regional Water Distribution Pipelines and Related Facilities owned or used by Metropolitan Water District

Framework of Key Contract Terms
Between San Diego County Water Authority
and
Metropolitan Water District of Southern California

On January 26, 2000, the Board received a Framework of Key Contract Terms Between the San Diego County Water Authority (Water Authority) and Metropolitan Water District of Southern California (Metropolitan or MWD) (the Framework [a copy of the Framework is attached for your convenience]). As previously noted, the Framework was the work product of collaboration between expert consultants including Tom Gaffney of Bartle Wells Associates; Mark Berkman and Jesse David of National Economic Research Associates; Chris Frahm of Hatch and Parent; and, Authority staff including Maureen Stapleton, Bob Campbell, Gordon Hess and Dan Hentschke (the "Team").

The purpose of this Workshop is to (1) develop a preliminary understanding of the Framework and its essential terms; (2) illustrate how the Framework seeks to address the policy issues and objectives that have been specified by the Board; and (3) obtain authorization to make a presentation to Metropolitan in February regarding the proposed essential terms of the Framework.

The following ten Discussion Points are intended to assist the Board in understanding the basic assumptions upon which the consultants have relied; and, suggest options that are available to assist the Board in achieving its objectives, and making timely and informed decisions in an orderly fashion.

Discussion Points

I. Discussion Point: Assumptions Regarding MWD Water Supply and Conveyance Capacity

Team Comments:

Questions:

Board Direction:

1. Accept the assumptions as a basis to proceed; or,

2. Revise the assumptions.

II. Discussion Point: Assumptions Regarding Water Source, Quality and Cost

A. Colorado River
B. State Water Project

Team Comments:

Questions:

Board Direction:

1. Accept the assumptions as a basis to proceed; or

2. Revise the assumptions.

III. Discussion Point: General Contract Terms

☞ A contract is a voluntary undertaking on the part of a willing buyer and a willing seller. A contract is legally enforceable. MWD does not have the right to force the Water Authority to enter into a contract, and the Water Authority does not have the right to force MWD to enter into a contract.

☞The Water Authority's current relationship with MWD is not contractual in nature.

☞ The Water Authority may wish to contract for only a portion of its supplies from MWD; it could also buy additional water from Metropolitan under any rate structure then in existence at MWD (Non-Contract Water).

☞ The Water Authority may wish to obtain other facilities, services and

capacity from MWD. The proposed contract terms currently contemplate a share of conveyance capacity proportional to the water supply purchase.

☞ The basic premise of the General Contract Terms is that Water Authority and MWD will specify the water and services MWD will provide and a formula by which Water Authority agrees to pay for the water and services. This will allow the Water Authority to establish a firm water right to the extent of its Contract Water, and, limit its future liability to the extent of its Contract Water for programs and services it does not contract to buy.

☞ As a contract, the negotiated terms would not be subject to unilateral change by MWD's Board of Directors nor by the Water Authority's Board of Directors.

☞ Supply and services are proposed to be based on facilities as of 1/1/00. Future capital programs, supplies, programs and related costs would require an agreement and future contract between the parties.

Team Comments:

Questions:

Board Direction:

1. Accept the assumptions as a basis to proceed; or

2. Revise the assumptions.

IV. Discussion Point: Cost of Water: Assumptions Regarding **Status Quo** and Risk of Financial Impacts of Roll-off

☞ Under the status quo, the MWD Board has the ability to build new facilities and acquire new water supplies (**i.e., spend money**) without knowing the extent to which customers will be available to pay for the facilities or water.

☞ There is a significant "roll-off" problem at MWD. There is both systemic and cyclic roll-off.

☞ At worst, the roll-off situation will result in fewer and fewer buyers of MWD water, thus driving up the cost of water for those who do buy it. At best, the roll-off factor, coupled with lack of control over spending, creates tremendous uncertainty as to the future cost to the Water Authority of MWD water.

☞ The current rate structure is a bundled rate, in which system-wide supply and distribution costs that bear little relationship to the customer's cost of service are included in the cost of water.

☞The current rate structure provides little relationship between costs of facilities and the benefits to member agencies on whose behalf costs are incurred. As a result, Water Authority customers are paying for projects and services that do not benefit them.

Team Comments:

Questions:

Board Direction:

1. Accept the assumptions as a basis to proceed; or,

2. Revise the assumptions.

V. Discussion Point: Risk and "Insurance" Cost Allocation of Water Service Reliability

☞Some member agencies are reluctant to make contractual promises to buy MWD water, because they don't know what their future sales or weather will be.

☞ Given these expressions of uncertainty about sales, a question is raised whether these agencies should be equally reluctant to spend money on capital projects and water supplies to meet uncertain needs.

☞ Under the status quo, Metropolitan "insures" its member agencies against uncertain weather and other contingencies by offering standby water and capacity,

but does not require agencies to pay the costs associated with this insurance risk mitigation.

☞ The cost of standby water, conveyance and treatment plant capacity, e.g., Diamond Valley Reservoir and Inland Feeder, is in the billions of dollars.

☞ MWD has no sources of revenue that it does not obtain from its member agencies, except limited property taxes and standby charges.

☞ Member agency risks don't change with or without MWD as the regional "insurance policy;" the real issue is, who pays, and how much.

☞ Under MWD's current rate structure, which is highly dependent on volumetric sales, the cost of holding water supply and capacity "on call" for member agencies is disproportionately paid by the agencies who rely upon MWD as their sole or primary supply source. Those agencies who purchase water infrequently – but in potentially large amounts – are not paying the fair costs (the insurance "premium") for the on-call water supply and capacity to serve them.

Team Comments:

Questions:

Board Direction:

1. Accept the assumptions as a basis to proceed; or,

2. Revise the assumptions.

VI. Discussion Point: Alternatives to a Rate Structure for MWD Supplies

☞ Any rate structure is subject to the discretion of the MWD Board of Directors, and thus, subject to change according to the will of the voting majority of the Board.

☞ The Metropolitan rate structure has been the subject of discussion,

uncertainty and ongoing revision for more than five years as the Board attempts to determine how to pay for projects it voted to approve without having a committed source of revenue to pay for them.

☞ The Water Authority needs to assure a reliable and cost-effective water supply.

☞ Under the Framework, the Water Authority would ensure the availability of water for which it would contract; at the same time, it could limit its liability to the actual costs of assuring that supply, as opposed to the shifting costs and risks inherent in MWD's current rate structure.

Team Comments:

Questions:

Board Direction:

1. Accept the assumptions as a basis to proceed; or,

2. Revise the assumptions.

VII. Discussion Point: Preferential Rights (see attached, *Excerpt from The Governance of the Metropolitan Water District of Southern California: An Overview of the Issues*, by Dennis O'Connor [August 1998])

☞ Under Section 135 of the MWD Act, each member agency has a "preferential right" to buy water. At this time, the Water Authority's preferential right is 14.39%, or, 303,630AF, assuming an MWD supply of 2.11 MAF.

☞ Preferential rights are calculated on the basis of each agency's historical payments to MWD for capital expenditures, excluding payments for the purchase of water.

☞ Water rate revenues are used to pay for capital facilities, but are not included in the calculation of preferential rights.

☞ The legal effect of the preferential rights law during times of drought and otherwise is uncertain; the uncertainty cannot be removed unless preferential rights are either legislatively eliminated or judicially determined.

☞ Section 135 could be changed or eliminated by the Legislature.

☞ The historical position of the City of Los Angeles is to assert and protect its preferential rights to water under Section 135.

☞ The Water Authority has attempted for more than thirty years to effect a change in the preferential rights formula at MWD.

☞ For purposes of its future planning, the Water Authority should assume preferential rights under current law unless the MWD Act is changed.

Team Comments:

Questions:

Board Direction:

1. Accept the assumptions as a basis to proceed; or

2. Revise the assumptions.

VIII. Discussion Point: Water Supply Priority

☞ The Framework proposes a contract under which MWD is obligated to deliver and the Water Authority is obligated to pay for water. The Water Authority would not be able to roll-off of MWD (reduce its purchases) to the extent of its Contract Water for the period of the contract.

☞ MWD would be required to meet its contractual commitments to member agencies first (Long Term Firm Supply, then Long-Term Interruptible Supply); the remaining water would be available for purchase in the Non-Contract Water pool.

☞ Agencies who choose not to enter into contracts and who choose, instead

in whole or in part to share shifting risks (weather, sales, etc.) and costs (who pays for the risks) may do so by buying water under the then-existing MWD rate structure (Non-Contract Water).

☞ A contract would establish a clear connection between what you get and what you pay.

Team Comments:

Questions:

Board Direction:

1. Accept the assumptions as a basis to proceed; or

2. Revise the assumptions.

IX. Discussion Point: Conveyance, Distribution, Treatment and Water Transfers

☞ The Water Authority should pay its fair share of the costs of conveyance facilities that bring water to MWD. Conveyance facilities are fairly defined as those upstream of any treatment plant.

☞ A "fair share" of the costs/liability associated with conveyance facilities would be that which is proportional to the rights to use the conveyance facilities.

☞ MWD has more capacity than it has water to fill it.

☞ The proportional right to use facilities should vest in the member agency who contracts to pay for the facilities. This would solve the "excess capacity" and wheeling problems MWD has experienced.

☞ Member agencies should be permitted to transport non-MWD water in capacity for which they have paid pursuant to contract.

☞ MWD's member agencies should not be forced to pay for treatment and distribution facilities that do not serve them. Distribution facilities are defined as

those "downstream" of a MWD water treatment facility.

☞ Lake Skinner is the only MWD water treatment facility and Pipelines 1-5 are the only MWD distribution facilities that serve the Water Authority.

Team Comments:

Questions:

Board Direction:

1. Accept the assumptions as a basis to proceed; or,

2. Revise the assumptions.

X. Discussion Point: Water Conservation and Local Projects

☞ The Water Authority strongly supports water conservation to reduce demand.

☞ All MWD member agencies should be in full compliance with Best Management Practices for water conservation.

☞ There are a number of alternatives how conservation could be funded. Each member agency could fund its own water conservation programs; the Water Authority could establish a fund with its savings from Metropolitan, for the benefit of programs in San Diego County; or, MWD could manage a fund in a non-discriminatory manner, the source of which would be subject to agreement.

☞ The Water Authority encourages the development of new local supply projects that are cost-effective and provide direct benefits to local agencies.

☞ Agencies who benefit from local supply projects should pay for them. In addition, MWD could establish a revolving fund in which (a) third-party sources of funding are sought; and (b) projects repay the fund under agreed terms.

Team Comments:

Questions:

Board Direction:

1. Accept the assumptions as a basis to proceed; or
2. Revise the assumptions.

FRAMEWORK OF KEY CONTRACT TERMS
SAN DIEGO COUNTY WATER AUTHORITY AND METROPOLITAN WATER DISTRICT*

Statement of MWD Capacity

MWD facility capacity	2.80 million acre feet per year (af/y)[1]
MWD firm supply[2]	2.11 million af/y[3]
Colorado River	1.00 million af/y
State Water Project	0.66 million af/y
Storage	0.45 million af/y
MWD current water deliveries	1.70 million af/y
Current excess facility capacity (facilities available but no water supply)	0.69 million af/y
Current standby capacity (water supply available)	0.41 million af/y

MWD Water Supply

Colorado River (CR) water is less expensive than State Water Project (SWP) water. SWP water cost varies with the amount of water delivered to MWD. CR water has lower useful quality because of significantly higher total dissolved solids (TDS) than SWP water. MWD charges a blended rate for water. Due to MWD policy, Water Authority receives a majority of CR water but pays the blended rate.[4]

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* This framework of key terms is a conceptual proposal and does not constitute and shall not be construed as an offer to contract.

[1] Estimated annual capacity of MWD facilities to deliver water and member agencies' ability to accept delivery of water, if supplies and demand were present. MWD's actual conveyance capacity for SWP and CRA supplies is 3.2 maf/yr. MWD's ability to deliver water at or above the estimated annual capacity depends upon the timing and location of such deliveries.

[2] See Attachment A "Allocation of Metropolitan's Existing and Committed Water Supplies."

[3] For the purposes of this proposal, Water Authority has assumed implementation of the "Key Terms for Quantification Settlement Among the State of California, IID. CVWD and MWD" dated October 15, 1999. Implementation of the Agreement for Transfer of Conserved Water between the Water Authority and IID and the Exchange Agreement between Water Authority and MWD is also assumed, but this water is an independent supply of Water Authority and is not included in determination of 2.11 million af of MWD firm supply. MWD available facility capacity would be reduced according to the schedule of water deliveries under the Agreement for Transfer of Conserved Water and the Exchange Agreement.

[4] Section 136 of the MWD Act states that MWD shall provide a 50 percent blend of SWP water and CR water to all of its members, to the extent reasonable and practicable. In the past MWD has delivered substantially more CR water than SWP water to the Water Authority. High TDS in CR water causes greater wear and tear on plumbing and appliances, increases demand for water softening, and adversely affects water recycling efforts. The cumulative impact of these effects has been substantial economic harm to

General Contract Terms

A contract or contracts between Water Authority and MWD will specify all of the water and services that MWD will provide and all of the costs that Water Authority will pay for water and services. The terms of the contract(s) may be amended by mutual agreement, but not unilaterally. For the specific water or service provided under the contract(s), methods to annually adjust costs for inflation and other factors beyond MWD's control would be incorporated and not subject to future MWD Board discretion. In addition, Water Authority's contract(s) for supply and services will be based upon facilities as of January 1, 2000 and will not include the costs related to new facilities, supplies, or other MWD programs. Such facilities, supplies and programs, and related costs could be the subject of future contracts or contract amendments.

Water Authority's contract could serve as a model for all of MWD's members. Because MWD's ability to commit to firm deliveries of water is subject to Section 135 of the MWD Act (preferential right to purchase water), Water Authority suggests consideration of long term enforceable contracts covering (a) a contract right to a minimum share of firm supply offered according to preferential rights, (b) a contract obligation to bear financial liability directly associated with those contract rights, and (c) a right to use specified conveyance facilities based upon a proportional allocation of MWD's full conveyance capacity. Water Authority would also consider contracting for an additional long term interruptible water supply (e.g. for agricultural and other purposes) from water that is available if agencies choose not to contract up to their preferential right. If claims of statutory preferential rights were eliminated, Water Authority would then consider contracting for additional firm supplies.

Water Supply

Water Authority will contract with MWD for a firm supply of water based upon actual costs of providing that water to Water Authority. Water Authority would, on a "take-or-pay" basis, contract for 303,630 af/y of MWD firm supply water (Water Authority's 14.39 percent preferential right of MWD's firm supply of 2.11 million af/y)[5]. This firm supply includes the proportional right to use MWD's facilities capacity for conveyance,

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water users in San Diego County. Additionally, Water Authority does not receive SWP water in proportion to the amount it pays to MWD.

[5] Water Authority is prepared to accept limitations on firm contact supply according to preferential rights so long as financial obligations are also contractually apportioned accordingly and accepted by the MWD member agencies that claim those rights. See Attachment B for a list of preferential rights as of 6/30/99.

distribution[6], and storage. Water Authority believes that it is in MWD's financial interest to contract with its member agencies for its entire firm water supply. However, Water Authority's contract proposal is not contingent upon MWD contracting with any of its other member agencies, and is independent of any other MWD contractual arrangements.

Water Authority expects to receive a blend of water proportionate to MWD's annual supply. If Water Authority receives a greater proportion of CR water, then MWD would credit Water Authority based on the actual proportion of less expensive CR water received[7]. MWD's costs for CR water and SWP water will be determined annually based on contract provisions and will not be subject to future discretion of the MWD Board.

Water Supply Priority

MWD water will be delivered in the following priority:

- Long-Term Firm Supply Contract Water
- Long-Term Interruptible Supply Contract Water
- Non-Contract Water

MWD would, as a first priority, deliver Long-Term Firm Supply Contract water to its member agencies. As a second priority, MWD would deliver Long-Term Interruptible Supply Contract water subject to the Interruptible Supply Contract terms. Non-Contract water would be a third priority. In any event, unless MWD declares a water supply emergency (Water Code § 350), MWD must deliver water at least up to the first two delivery priorities according to contract terms.

In the event that MWD has a water supply above its firm supply (i.e. greater than 2.11 million af/y), then such water shall be offered to it member agencies at its marginal cost in proportion to their preferential rights, provided however, that the member agency must first, in any given year, purchase up to its preferential rights at the Non-Contract water price.

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[6] MWD's conveyance facilities are generally defined as its aqueducts and other water transmission facilities located "upstream" of a MWD water treatment facility (or for untreated lines the nearest treatment facility). MWD's water distribution facilities are generally defined as its pipelines and other water transmission facilities located "downstream" of a MWD water treatment facility (or for untreated lines the nearest treatment facility). Under this proposal, Water Authority would assume a significant portion of the cost for the "distribution" facilities of the MWD pipelines downstream of Lake Skinner.

[7] Limitations on the availability of water from the SWP affect MWD's ability to provide blend water. The maximum blend standard should be the ratio of SWP water purchased by MWD in a year to the CR water available in that year.

Water Conservation

Water Authority strongly supports water conservation to reduce water demand. Therefore, MWD, Water Authority, and all other MWD member agencies (and subagencies) must be in full compliance with the Memorandum of Understanding Regarding Urban Water Conservation in California as it pertains to implementation of "Best Management Practices" (BMPs) for water conservation. MWD conservation programs should be funded and administered in a non-discriminatory manner.

Local Project Water Development

Water Authority encourages development of new local water supply projects including wastewater reclamation, groundwater recovery, desalination, and other similar supply projects. These projects provide direct benefits to local agencies. Projects not in existence[8] on January 1, 2000 should be funded by contract(s) with the local agency benefiting from the project or other agencies desiring to contract for a portion of the supply created by the project. MWD's role, if any, could be to establish and administer a revolving fund of member agencies that choose to participate in projects for local supply development on a voluntary basis. Costs for projects in existence on January 1, 2000 could be funded by a non-discriminatory surcharge on all member agencies.

Treatment

MWD's water supply for Water Authority is treated at the Skinner Filtration Plant. Water Authority currently uses about 75 percent of the plant capacity. Western and Eastern Municipal Water Districts use the remaining capacity. Water Authority water is not treated at any other MWD facility. Water Authority would consider accepting financial responsibility for the Skinner Filtration Plant subject to an appropriate share of expenses to be borne by Eastern and Western.

Storage

MWD storage includes operational storage, emergency storage, and dry year supply. Water Authority would contract for emergency storage at Diamond Valley Lake (formerly Eastside Reservoir) in proportion to its preferential right according to the

[8] For the purposes of this Framework, projects in existence include projects actually in existence or under construction pursuant to a contract with MWD on January 1, 2000 and those certain 14 Local Resources Program projects listed in the memorandum titled "Local Resource Program Recommended Project Mix" presented to and approved by the MWD Board on December 7, 1998 following an RFP process.

principles described above.[9] Operational storage and dry-year supply storage are included in supply costs under Long-Term Firm Supply Contracts. Operational storage, but not necessarily dry-year supply costs are included in supply cost under Long-Term Interruptible Supply Contracts.

RELATED ISSUES

MWD Reserves

With a contract approach that guarantees revenues, MWD would no longer require large unrestricted reserve fund balances. Current MWD unrestricted reserves are expected to increase from additional surplus revenues and investment earnings this year.

After allowance for bond and other restricted reserves, MWD should determine the source of remaining surplus reserves and distribute these surplus reserves to those agencies contractually committed to providing firm revenues in proportion to their source. Based on a share of past water sales revenues, Water Authority would be entitled to about 26 percent of the distributions. Distributions could be in the form of credits against future payment obligations.

Wheeling

Wheeling should be provided by MWD to Water Authority in accordance with state law. To the extent necessary, MWD and its member agencies could seek changes to reconcile the new contracts and rate structure with state law. Wheeling disputes with member agencies that enter into water contracts, which include unused capacity, would no longer exist, because the member agency would have the right to use its contract capacity to transport non-MWD water.

[9] If claims of statutory preferential rights were eliminated, Water Authority would consider contracting for additional emergency storage.

Property Taxes

Property taxes levied by MWD to pay debt service on outstanding bonds would not be affected by contracts with member agencies, provided, however, that such payments would be recognized in the contract terms. Additional tax levies would be prohibited unless specifically provided by contract and authorized pursuant to law.

MWD Rates and Charges

To the extent that member agencies contract with MWD, the various rates and charges such as standby or readiness-to-serve charges, connection maintenance charges, and other new demand charges would no longer apply, instead the cost of providing water and services would be determined by the contract(s) terms. Existing standby charges that are assessments under Article XIII D of the California Constitution could continue subject to appropriate recognition in the contract terms. Rates and charges for water and services not provided by contract would be determined by MWD according to law.

ALLOCATION OF METROPOLITAN'S EXISTING AND COMMITTED WATER SUPPLIES

	%	SWP	CRA*	Semitropic/ Arvin	Las Posas	Eastside	DWR Reservoirs	Total
Absolute Firm, 4-6 Year Drought	1.3%	0.40	1.00	0.10	0.00	0.00	0.00	1.50
(after most storage is depleted)	1.3%	0.56	1.00	0.10	0.00	0.00	0.00	1.66
	1.3%	0.62	1.00	0.10	0.00	0.00	0.00	1.72
	3.9%	0.53	1.00	0.10	0.00	0.00	0.00	1.63
1-3 Year Drought	1.3%	0.25	1.00	0.12	0.07	0.17	0.07	1.68
(with significant storage yield)	1.3%	0.59	1.00	0.12	0.07	0.17	0.07	2.02
	1.3%	0.61	1.00	0.12	0.07	0.17	0.07	2.04
	1.3%	0.70	1.00	0.12	0.07	0.17	0.07	2.13
	1.3%	0.76	1.00	0.12	0.07	0.17	0.07	2.19
	1.3%	0.84	1.00	0.12	0.07	0.17	0.07	2.27
	1.3%	0.88	1.00	0.12	0.07	0.17	0.07	2.31
	9.1%	0.66	1.00	0.12	0.07	0.18	0.08	2.11

MWD Demands	Projected (2010) Normal	Dry
Firm (non-interruptible)	1.78	2.06
Agricultural	0.11	0.13
Long-term replenishment/seasonal	0.16	0.21
Total	2.05	2.40

Storage	Total Cap. (AF)	Max Take (AFY)	3 Year Take (AFY)
Eastside	500,000	500,000	170,000
DWR Res.	220,000	220,000	70,000
Las Posas	210,000	70,000	70,000
Semi/Arvin	700,000	120,000	120,000
Total	1,630,000	910,000	430,000

* Assumes that SD/IID Transfer is not allocated as a MWD supply, with demands on MWD also being reduced by transfer amount.

11/6/98

ATTACHMENT A

MEMBER AGENCIES	Tax Collected	% of Taxes	Others	RTS Charges	TOTAL	% of Total
Los Angeles County:						
Beverly Hills	30,841,869.85	1.07%	322,785.59	2,533,184.61	33,697,840.05	1.02%
Burbank	28,133,913.24	0.98%	288,489.05	4,018,487.11	32,440,889.40	0.98%
Central Basin MWD	266,282,203.44	9.25%	3,638,124.61	20,961,050.12	290,881,378.17	8.77%
Compton	8,074,318.86	0.28%	41,174.33	1,132,724.88	9,248,218.07	0.28%
Foothill MWD	20,566,533.74	0.71%	28,486.12	2,172,060.05	22,767,079.91	0.69%
Glendale	34,858,603.35	1.21%	187,119.15	5,957,472.44	41,003,194.94	1.24%
Las Virgenes MWD	16,606,397.44	0.58%	114,252.68	4,410,581.80	21,131,231.92	0.64%
Long Beach	81,269,458.61	2.82%	397,771.22	10,133,667.33	91,800,897.16	2.77%
Los Angeles	706,028,885.81	24.53%	5,763,164.22	50,060,977.16	761,853,027.19	22.98%
Pasadena	33,045,059.49	1.15%	93,572.34	3,539,585.32	36,678,217.15	1.11%
San Fernando	3,525,141.70	0.12%	37,724.63	263,949.64	3,826,815.97	0.12%
San Marino	6,840,722.13	0.24%	-	344,230.07	7,184,952.20	0.22%
Santa Monica	30,759,171.04	1.07%	33,176.51	1,518,197.39	32,310,544.94	0.97%
Three Valleys MWD	59,743,168.71	2.08%	2,494,532.92	15,027,105.86	77,264,807.49	2.33%
Torrance	34,226,935.05	1.19%	283,944.38	4,819,640.11	39,330,519.54	1.19%
Upper San Gabriel MWD	138,937,909.89	4.83%	2,017,800.65	6,510,102.58	147,465,813.12	4.45%
West Basin MWD	234,075,404.73	8.13%	1,476,090.28	35,072,329.68	270,623,824.69	8.16%
Total -L.A. County	1,733,815,697.08	60.25%	17,216,208.68	168,475,346.15	1,919,509,251.91	57.90%
Orange County						
Anaheim	20,863,797.69	0.72%	78,293.95	4,871,994.55	25,814,086.19	0.78%
Coastal MWD	69,677,782.88	2.42%	412,040.58	9,453,324.93	79,543,148.19	2.40%
Fullerton	17,582,237.54	0.61%	383,207.71	2,215,938.62	20,181,383.87	0.61%
MWD of Orange County	324,737,012.62	11.28%	6,608,027.68	45,476,485.20	376,821,525.50	11.37%
Santa Ana	20,866,758.66	0.73%	58,233.58	3,387,794.40	24,312,786.64	0.73%
Total - Orange County	453,727,589.39	15.77%	7,539,803.30	65,405,537.70	526,672,930.39	15.89%
Riverside County						
Eastern MWD	74,128,987.57	2.58%	3,455,425.34	15,854,133.64	93,438,546.55	2.82%
Western MWD	91,276,740.75	3.17%	2,304,176.79	17,728,149.42	111,309,066.96	3.36%
Total - Riverside County	165,405,728.32	5.75%	5,759,602.13	33,582,283.06	204,747,613.51	6.18%
Chino Basin MWD (San Bernardino)	66,467,677.39	2.31%	1,926,649.66	10,450,015.79	78,844,342.84	2.38%
SDCWA (San Diego)	372,188,777.01	12.93%	1,179,386.82	103,781,149.08	477,149,312.91	14.39%
Calleguas MWD (Ventura)	86,259,245.90	3.00%	491,091.86	21,382,551.76	108,132,889.52	3.26%
TOTAL WITHIN DISTRICT	2,877,864,715.09	100.00%	34,114,742.45	403,076,883.54	3,315,056,341.08	100.00%

1 Includes Service Connections and cash contributions

The board conducts its regular business at its full board meeting. For most items on the agenda, one or more standing committees will make a recommendation to the full board. The full board then discusses the item and takes a vote. Usually, the chair calls for a voice vote. The board rarely needs to use the full weighted voting system to determine the outcome of a vote.

In addition to the regular board meetings, the board often holds special meetings and ad-hoc committee meetings.

Under the Administrative Code, the General Manager is the chief executive officer of MWD. The board appoints the General Manager by a majority vote. The General Manager oversees the day-to-day operations of MWD and "shall exercise all executive, administrative, and ministerial powers not specifically reserved to the Board, General Counsel or Auditor."[14] The board similarly appoints the General Counsel and Auditor by a majority vote. The General Manager, along with the General Counsel and Auditor, serves at the pleasure of the Board.

PREFERENTIAL WATER RIGHTS

Under Section 135 of the MWD Act, each member agency has a *preferential right to water*. This right is determined by each agency's total historic payments to MWD for capital expenditures, excluding payments for the purchase of water. Therefore, agencies that have paid the most property tax and "ready-to-serve" charges to MWD have the largest right to water. Under the preferential rights rules, during periods of water shortage, MWD would allocate water without regard to historic water use or dependence on MWD.*

It is important to note at the outset, that there is controversy over whether the preferential water rights rules would ever be implemented, or if they are even legal. The MWD board has never implemented preferential water rights; not even with the severe shortages during the 1976-77 or 1988-92 droughts. Instead, during the recent drought the board reduced all water deliveries proportionally the same.† Moreover, the board is considering a drought management plan that would purportedly dismiss preferential rights as a means of allocating water.

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* In 1925, the California Senate, in one of its first amendments to the proposed Act, created the preferential water rights. The apparent rationale was that because the initial construction of the Colorado Aqueduct and the appurtenant facilities would be financed with local property tax revenues (which are based on assessed value), those agencies with the greatest financial burden should have the greatest rights to the water. For additional history of the formation of MWD, see Appendix.

† The reductions were based on 1989-90 sales. Interruptible water was reduced a greater percentage than firm water sales.

Furthermore, MWD's Deputy General Counsel argues that California Water Code sections 350 et seq. supercede the provisions of the MWD Act regarding preferential water rights.* Section 350 states:

> §350. The governing body of a distributor of a public water supply ... may declare a water shortage emergency condition to prevail within the area served by such distributor whenever it finds and determines that the ordinary demands and requirements of water consumers cannot be satisfied without depleting the water supply of the distributor to the extent that there would be insufficient water for human consumption, sanitation, and fire protection.[15]

Later sections of that same chapter declare that under such an emergency declaration, the governing boards may adopt regulations and restrictions on the delivery of water that will conserve the water supply for the greatest public benefit.[16] Furthermore, the provisions of §§350 et seq. prevail over any conflicting laws, such as the MWD Act.[17]

However, §§350 et seq. apply only when the governing body declares a water shortage emergency. If, during a period of shortage, the MWD board chose not to follow the provisions of §§350 et seq. and did not declare such an emergency, §§350 et seq. would not be in effect.† In such a situation, preferential water rights under the MWD Act would apply.

In addition, while developing drought management plans before the beginning of a drought is laudable, MWD board policy cannot supercede state law; in this case the MWD Act. Again, in the absence of a declared water shortage emergency, preferential water rights under the MWD Act would apply.

Generally, member agencies with the highest assessed value have the highest preferential rights. (See Table 9.) However, the more interesting question is how well do these preferential rights fit with local water resources needs.

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* It is interesting to note that two previous General Counsels came to different conclusions on the question of §§350 et seq. For a history of MWD's actions regarding preferentaial water rights, including legal opinions by various General Counsels, see: MWD, "Source Materials on Metropolitan Water District Act Section 135: Preferential Rights," January 11, 1996.

† Moreover, there is nothing in §§350 et seq. that compels a water district to declare such an emergency. In addition, as long as water was being put to a "reasonable and beneficial use," restrictions under Article X, section 2 of the California Constitution would also not apply. The definition of "reasonable and beneficial use" is also subject to debate.

Table 9
Preferential Water Rights: 1997
($ Thousands)

Member Agency	Tax Collected	Ready-to-Serve Charges	Misc. Other	Total*	Preferential Rights (% of Total)
City of Los Angeles	$667,333	$33,007	$5,763	$706,104	23.78%
San Diego County WA	343,580	60,618	1,174	405,372	13.65%
MWD of Orange County	300,573	27,020	5,412	333,005	11.21%
Central Basin MWD	255,246	13,631	3,196	272,073	9.16%
West Basin MWD	220,558	19,277	1,473	241,308	8.13%
Upper San Gabriel Valley MWD	131,513	5,664	2,018	139,195	4.69%
Western MWD	82,789	11,553	2,272	96,613	3.25%
Calleguas MWD	80,282	11,265	472	92,019	3.10%
City of Long Beach	77,587	5,694	398	83,678	2.82%
Eastern MWD	66,995	10,622	3,443	81,060	2.73%
Chino Basin MWD	61,814	6,847	1,927	70,587	2.38%
Coastal MWD	64,474	5,334	412	70,220	2.36%
Three Valleys MWD	54,982	8,933	2,212	66,127	2.23%
City of Glendale	32,767	3,219	187	36,173	1.22%
City of Torrance	32,276	2,702	284	35,261	1.19%
City of Pasadena	31,285	1,838	94	33,216	1.12%
City of Beverly Hills	28,914	1,209	323	30,446	1.03%
City of Santa Monica	29,301	985	33	30,319	1.02%
City of Burbank	26,696	2,305	288	29,290	0.99%
City of Santa Ana	19,278	2,077	58	21,413	0.72%
City of Anaheim	18,069	2,883	78	21,030	0.71%
Foothill MWD	19,195	1,342	28	20,566	0.69%
City of Fullerton	16,513	1,497	383	18,394	0.62%
Las Virgenes MWD	14,632	2,534	114	17,281	0.58%
City of Compton	7,699	739	41	8,479	0.29%
City of San Marino	6,403	206	0	6,610	0.22%
City of San Fernando	3,238	182	38	3,458	0.12%
Total*	$2,693,992	$243,183	$32,121	$2,969,296	100.00%

* Detail may not add due to independent rounding
Source: MWD

Two agencies, the City of Anaheim and SDCWA, typically buy twice the amount of water that they would have under preferential rights. As shown in Table 10, about half of the member agencies have used a greater share of water than they have under their preferential rights. If during shortages, MWD allocated water under the preferential rights rules, these agencies would be the first to be cut. Conversely, a near equal number of agencies use less water than they have preferential rights. Depending on the severity of a shortage, many of these agencies could completely avoid any delivery reductions simply by exercising their preferential rights.

Table 10
Average MWD Direct Deliveries:
Actual vs. Preferential Rights

Member Agency	10 Year Average (Table 6)		10 Year Average Under Preferential Rights		Percent Difference
	AF	% of Total	AF	% of Total	
City of Anaheim	25,891	1.5%	12,563	0.7%	-51.5%
San Diego County WA	496,815	28.0%	242,172	13.7%	-51.3%
Calleguas MWD	93,221	5.3%	54,973	3.1%	-41.0%
Las Virgenes MWD	17,452	1.0%	10,324	0.6%	-40.8%
Three Valleys MWD	62,208	3.5%	39,505	2.2%	-36.5%
City of Santa Ana	16,517	0.9%	12,792	0.7%	-22.5%
City of Fullerton	13,256	0.7%	10,989	0.6%	-17.1%
City of Pasadena	23,898	1.3%	19,844	1.1%	-17.0%
City of Glendale	25,213	1.4%	21,610	1.2%	-14.3%
City of Burbank	20,412	1.2%	17,498	1.0%	-14.3%
MWD of Orange County	208,434	11.8%	198,939	11.2%	-4.6%
Western MWD	60,239	3.4%	57,717	3.3%	-4.2%
West Basin MWD	148,484	8.4%	144,159	8.1%	-2.9%
Coastal MWD	41,550	2.3%	41,950	2.4%	1.0%
City of Torrance	20,124	1.1%	21,065	1.2%	4.7%
City of Long Beach	47,275	2.7%	49,990	2.8%	5.7%
City of Compton	4,751	0.3%	5,065	0.3%	6.6%
Eastern MWD	44,262	2.5%	48,426	2.7%	9.4%
Chino Basin MWD	36,606	2.1%	42,169	2.4%	15.2%
Foothill MWD	9,893	0.6%	12,286	0.7%	24.2%
City of Beverly Hills	13,836	0.8%	18,189	1.0%	31.5%
City of Los Angeles	238,474	13.4%	421,831	23.8%	76.9%
Central Basin MWD	83,975	4.7%	162,538	9.2%	93.6%
City of Santa Monica	8,443	0.5%	18,113	1.0%	114.5%
City of San Fernando	826	0.0%	2,066	0.1%	150.1%
City of San Marino	971	0.1%	3,949	0.2%	306.7%
Upper San Gabriel Valley MWD	10,852	0.6%	83,156	4.7%	666.3%
Total*	1,773,877	100.0%	1,773,877	100.0%	

* Detail may not add due to independent rounding
Source: Tables 6 & 9

However, the effect such cuts would have on each member agency are complicated by the agency's dependence on MWD for water. MWD supply reductions affect agencies with large local supplies less than agencies with small local supplies. That is because for agencies with large local supplies, MWD supplied water makes up a relatively small portion of their total water budget. Consequently, reductions in MWD deliveries would affect a small part of their total water budget.

Table 11 Total Local Water Supplies Actual vs. Hypothetical 20% MWD Shortage & Preferential Rights			
Member Agency	Average Annual Use (Table 6)	Hypothetical 20% MWD Shortage & Preferential Rights	Percent Difference
San Diego County WA	583,703	280,625	-51.9%
Las Virgenes MWD	20,896	11,703	-44.0%
Calleguas MWD	120,598	71,355	-40.8%
City of Burbank	22,632	16,218	-28.3%
City of Glendale	29,677	21,752	-26.7%
Three Valleys MWD	115,551	84,947	-26.5%
City of Anaheim	70,603	54,763	-22.4%
City of Pasadena	37,096	29,073	-21.6%
West Basin MWD	188,445	155,288	-17.6%
Coastal MWD	48,245	40,255	-16.6%
City of Fullerton	32,430	27,965	-13.8%
City of Santa Ana	48,207	41,924	-13.0%
MWD of Orange County	418,077	368,794	-11.8%
City of Torrance	29,388	26,116	-11.1%
City of Long Beach	74,561	67,278	-9.8%
City of Compton	10,238	9,539	-6.8%
Western MWD	248,565	234,500	-5.7%
Eastern MWD	138,889	133,368	-4.0%
Chino Basin MWD	195,471	192,600	-1.5%
Foothill MWD	16,085	16,021	-0.4%
City of Beverly Hills	13,836	14,551	5.2%
City of Los Angeles	650,818	749,809	15.2%
Central Basin MWD	255,303	301,359	18.0%
City of San Fernando	2,876	3,702	28.7%
Upper San Gabriel Valley MWD	174,685	230,358	31.9%
City of Santa Monica	16,569	22,616	36.5%
City of San Marino	5,410	7,598	40.4%
Source: CRB			

To illustrate these interactions, Table 11 shows how a hypothetical 20 percent reduction in MWD supplies would affect member agencies' total supplies under preferential water rights rules.* The table compares the agency water use from Table 6 to the hypothetical scenario. This scenario assumes shortfalls only in MWD supplies – each member agency's local supplies are assumed to remain constant.

* This scenario is strictly for illustrative purposes only and does not purport to reflect a realistic drought scenario. For example, it does not reflect the fact that some agencies, such as the City of Los Angeles, place significantly higher demands on MWD for water during droughts than during average water years.

The comparison shows that under strict preferential rights rules, a 20 percent reduction in MWD supplies would lead to a 51.9 percent reduction in total water available to SDCWA. Similarly, Las Virgenes MWD and Calleguas MWD would both experience a more than 40 percent reduction. Conversely, some agencies would, hypothetically, gain water. Naturally, such agencies would in reality turn back some of their MWD supplies to be redistributed among the other member agencies. However, this scenario does illustrate how under current rules, agencies like Los Angeles, Upper San Gabriel Valley and San Marino have very secure supplies compared to highly vulnerable such as to SDCWA, Las Virgenes MWD and Calleguas MWD.

CONCLUSIONS

As noted in the introduction, it seems that much of the current debate has been focused on symptoms of problems, and not the sources of the problems. Some examples:

- There has been much debate regarding the proposed water transfer between SDCWA and the IID and the actions and reactions of various parties. While questions of ethical behavior are clearly important, the root cause of the conflict stem from a fundamental disagreement on what MWD's job is and is not. SDCWA and others believe MWD job is to be *a* source of supplemental water for the region, *among possible other sources*. Others believe MWD' job is to be *the sole* source of supplemental water. This distinction is not trivial, and it is this lack of consensus that led to the current conflicts.

- A number of people observe that MWD has sizable unrestricted reserves and question MWD's resolve to keep rates low for the ratepayer. While not specifically addressed in this report, this issue again gets to what is and is not MWD's job. If MWD's principal job is to meet member agency needs, then there could be advantages to MWD carrying large reserves instead of each member agency. However, if MWD's principal job is to provide water at the lowest possible cost, then perhaps the rate structure needs adjusting.

- There have been a number of questions regarding the appropriate size of the board. In particular, some feel that the board would operate much more efficiently with fewer members. It is generally true that smaller boards operate more efficiently than larger boards. And, efficiency is an important goal in designing or reforming a governance structure. However, efficiency is a question of ensuring *things are done right*. The more important governance issue is ensuring that *the right things are done*. By focusing on size, one avoids the question of who is best suited to oversee the organization. It might be the case that only representatives of each member agency can ensure MWD achieves its mission. However, if it is not, then simply changing the number of board members is a largely meaningless exercise.

These issues illustrate the need to address the root governance issues, and not simply the symptoms.

The current conflicts between SDCWA and other member agencies warrant special comment. Some have complained that SDCWA is trying to destroy MWD. In their view, SDCWA has received a number of benefits from MWD in the past and ought to be grateful for those benefits. They complain that SDCWA is looking for special treatment

because it is the largest customer. In essence, they complain that SDCWA is trying to change the *status quo* fundamentally, and MWD with it.*

What these critics ignore is that under the *status quo*, SDCWA has the most at risk and with only 15.7 percent of the vote, simply has not power within MWD to reduce that risk.† No other agency is as dependent on MWD for water *AND* as disadvantaged by the preferential water rights rules. If MWD faced a 20 percent supply shortfall and, for some reason, the board did not declare a water emergency under §§350 et seq., SDCWA would be in a potentially dangerous situation. If just one member agency pressed its preferential rights, the dominos would begin to fall, numerous law suits and counter suits would be filed, and SDCWA could be facing a 50 percent shortfall. Given its situation, it would be both irrational and irresponsible for SDCWA not to try to improve its water supply reliability. If SDCWA is unable to improve its reliability within MWD, then it must do so outside of MWD.

The maxim *form follows function* fits. To resolve MWD's governance problems, it is important to answer each of the three questions:

(1) What is and is not MWD's job?
(2) Who is best suited to ensure MWD does this job properly?
(3) How should (2) make these decisions?

Considering just (1), there are at least three key issues:

- Should MWD be the sole supplier of supplemental water to Southern California?
- What should MWD's official rules under the MWD Act be for allocating water during periods of drought?
- Whose interests should MWD primarily represent – member agencies, retail water agencies, end users, the taxpayers, or someone else?

It might well be that in answering these questions, it is found that the current system requires just a little fine-tuning. Nonetheless, it might just as easily be that such an investigation would lead to a dramatically different governance structure. The outcome depends at least in part on who is and is not answering the questions.

However MWD's job is defined, there are many legitimate questions regarding member agency equity and financial security for MWD. Still, it is possible to change or clarify MWD's mission and still protect common goals. For example, one concern is that if member agencies can transfer water from outside the MWD service area, potential water sellers could play one member agency against another to get a higher price and therefore increase profits. One solution would be for MWD to act as a broker for any such

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* They also assert that SDCWA representatives have acted unethically. That is a separate issue.

† Moreover, it is doubtful that SCDWA could form a coalition of similarly affected agencies with sufficient vote strength to change their situation.

FACTS & FIGURES

- SDCWA provides more than 27.2 percent of MWD's current revenue
- SDCWA has provided more than 21.8 percent of MWD's historical total revenues
- SDCWA has provided more than 21.7 percent of MWD's historical capital contributions

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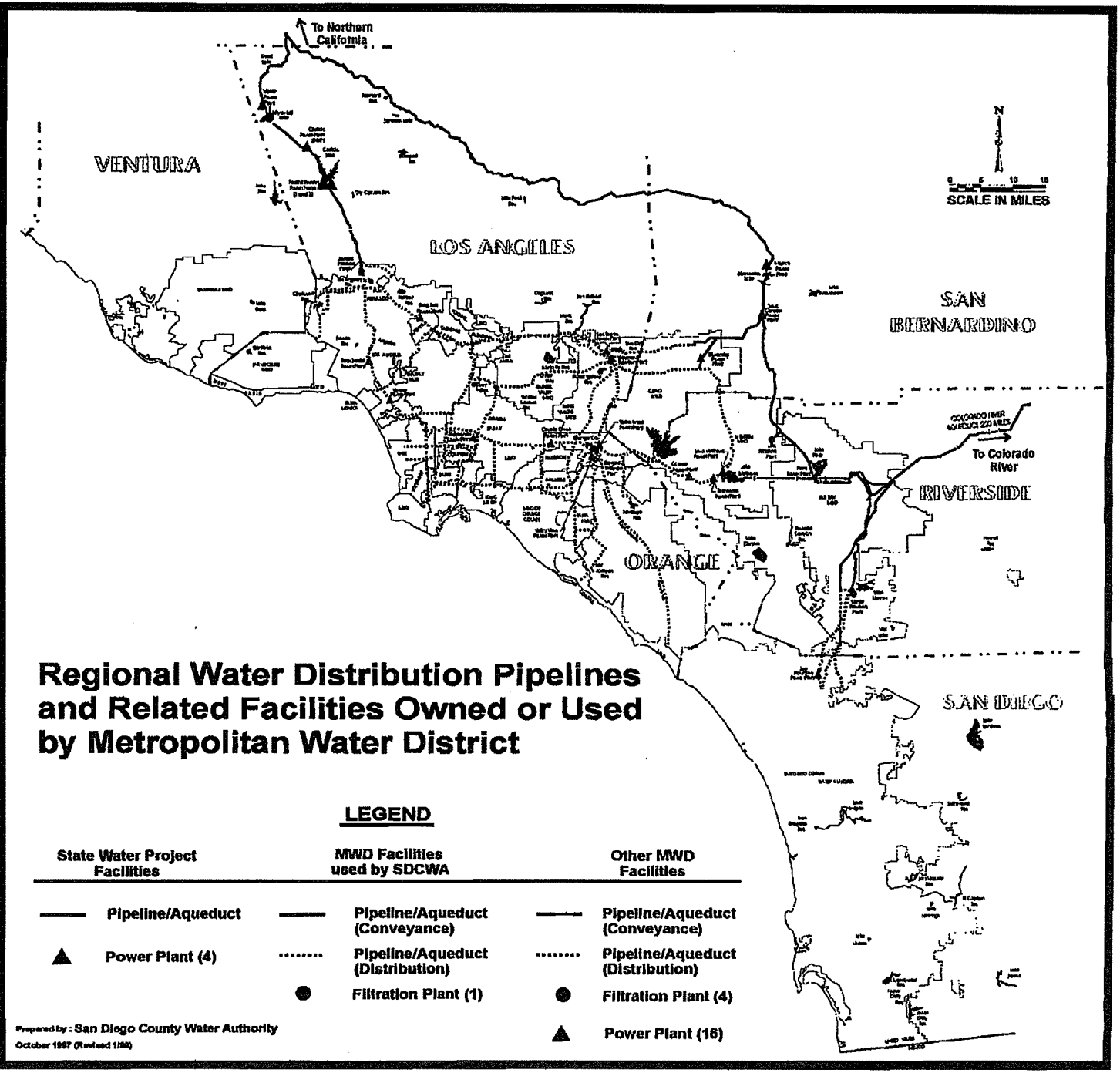
- SDCWA uses less than 17 percent of MWD's 775 mile distribution system
- SDCWA has about 12 percent of MWD's connected capacity
- SDCWA has a preferential right to about 14.4 percent of MWD supplies
- SDCWA has about 16.7 percent of MWD voting entitlement



Comments on Contracts by Jeffrey Kightlinger,
General Manager of the Metropolitan Water District of Southern California,
Aug. 10, 2010 San Diego Public Workshop on
MWD's 2010 Integrated Resources Plan

"A quick comment on contracts. That is an interesting point. Metropolitan and all the State Water Contractors agreed to what are commonly referred to as 'take-or-pay' contracts. I've never understood the word 'or,' because the reality is, you pay regardless of what you take, to be honest. So it's more like 'pay' and 'sometimes take.' But, these 'take-or-pay' Contractors, we have made a firm commitment to the State of California that we are going to pay half of the fixed costs of the State Water Project every single year, regardless of whether we get one drop of water from the project. There has been debate within Metropolitan that perhaps Member Agencies should do that same kind of commitment as well, so there is a certain base-load of funding and financing available for our projects. Because Member Agencies develop local resources on their own, and start using less and less of Metropolitan water. To date, that while staff thinks contracts are a terrific idea, to date, most of our board members have said 'we're not so sure about that.' And, most of our Member Agencies have said 'No. Thanks, but no thanks, because we prefer this the way it is.' We do try to, though, keep a certain amount of our revenue stream in fixed costs, and a certain amount of our revenue stream in the water supply. But, right now it's about 80% or more comes from the sale of water. We have about 15% in property taxes, and we've slowly but surely added to a fixed fee that everybody pays every single year.[1] But that's an ongoing debate within Metropolitan. Should people make those firm commitments going into the future? So far, the Member Agencies have opted not to. They prefer it the way it is. I think we're going to continue to have that discussion at Metropolitan, particularly as costs increase.

"Oh, and we'll definitely take that into consideration, I definitely want to make sure that's put into the Integrated Resources Plan.[2] Because I do believe, if we are successful – and this is something I keep telling people - if we are successful on the State Water Project – and success means a very expensive eco-system rehab project the size of what we've done in the Florida Everglades, and success means building a new tunnel or canal that we're looking in the eight- to 12-billion-dollar range with the State of California - and Metropolitan coming on board to pay 25% of that cost – that's a significant new cost that Metropolitan, the next generation of Metropolitan ratepayers will be paying. And we need to take a look at different financing mechanisms that everyone is comfortable with region-wide."

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[1] Property taxes amount to approximately 5 percent of MWD's revenues. Including property taxes, only 16 percent of MWD's revenues are fixed.

[2] Requirement for firm contractual commitments by Member Agencies to pay MWD's State Water Project costs was not included in MWD's adopted 2010 Integrated Resources Plan.

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

BOARD ACTION

- Board of Directors
  Water Planning and Stewardship Committee

5/10/2011 Board Meeting

5-1

Subject

Approve calendar year 2011 approach for purchases of water for local storage

Description

Summary

In order to optimize the reliability of water supply in to the service area, Metropolitan provides water supplies to member and local agencies for the replenishment and management of groundwater and other local storage under the Replenishment Service Program, groundwater conjunctive use programs, and cyclic storage accounts. Providing replenishment supplies has the potential to achieve greater conjunctive use of imported and local supplies, to encourage construction of additional local production facilities, and to provide dry-year supplies to meet water needs of the member agencies. In the past, Metropolitan has offered water for local storage at a discounted water rate under the Replenishment Service Program. However, as California entered into drought, the General Manager discontinued discounted sales in 2007. During the past year, while the region was under mandatory water allocations under the Water Supply Allocation Plan, Metropolitan approved a Water Management Program that did not offer a discounted replenishment water rate but facilitated storage purchases by shielding water management actions from higher penalty rates.

There are concerns about the performance and equity of the existing Replenishment Service Program and its associated discounted water rate and its performance during a period of constrained State Water Project deliveries. Metropolitan is currently engaged in a process with the member agencies to develop potential refinements to the Replenishment Service Program. The intention of this process, which should be completed by the end of this year, is to develop options for Board consideration that would address concerns with the existing program and better achieve the goal of increasing regional water supplies. **Attachment 1** shows Section 4514 of the Administrative Code (Code) pertaining to the goals and aspects of the Replenishment Service Program.

At this time, Metropolitan faces the unexpected challenge of managing and storing large amounts of supply in 2011. Due to a combination of low demands and favorable water supply conditions, Metropolitan will likely have at least 790 TAF of supplies to store this year under supplies currently allocated to Metropolitan which total 2.5 MAF. Under this scenario, net additions to storage could increase dry-year storage reserves to more than 2.3 MAF by the end of 2011, the highest end-of-year total reserves in Metropolitan's history. Additionally, there are a number of factors that could result in even higher levels of water supplies being available. Any additional water supplies beyond the current 2.5 MAF would be challenging to manage using available storage. An interim program to facilitate local storage would help to manage additional supplies should they become available.

This letter offers four options to help in managing these potentially excess water supplies for CY 2011.

- Option 1 - Manage additional water supplies using Metropolitan's dry-year storage portfolio.
- Option 2 - Amend the existing Water Management Program to allow agencies to purchase and store additional supplies with an exemption from Tier 2 supply rates and Capacity Charges through the end of CY 2011.

- Option 3 - Offer water under the existing Replenishment Service Program and the associated discounted water rate, in an amount limited to additional increases beyond current water supplies.
- Option 4 - Offer water under the existing Replenishment Service Program and the associated discounted water rate on an ongoing basis with no pre-set limits as to the amount of water offered.

The options are intended to put an interim approach in place to address the immediate water management needs for CY 2011 only. These options do not replace the need for the ongoing long-term Replenishment Service Program development process.

Issues with the Current Replenishment Service Program

The Code authorizes the General Manager to offer replenishment water deliveries under the Replenishment Service Program. This program is currently in place but deliveries under the program have not been made available to the member agencies since 2007 due to water supply concerns. The goal of the Replenishment Service Program is to provide a regional water management benefit. However, the Replenishment Service Program, in its current state, has generated concerns about its effectiveness. During the Groundwater Workgroup process, which was a facilitated process with member agencies and groundwater managers that met between July 2008 and February 2009, discussions on replenishment indicated that there are a number of concerns with the current program. These issues included questionable and unquantifiable performance and expectations, the potential of shifting water sales within a year as opposed to generating true longer-term storage, the potential offset of full service sales, unequal distribution of costs and benefits among participating and non-participating agencies, questions on whether water was being stored for future use as opposed to being purchased to refill overdraft, difficulties in measuring and verifying in-lieu deliveries to storage, and cash-flow and budgeting issues associated with the frequency under which replenishment supplies are available.

In March 2011, Metropolitan and its member agencies kicked off a Replenishment Workgroup Process to address issues with the current Replenishment Service Program and develop a new approach for facilitating the replenishment of local storage in the future. The Replenishment Workgroup Process is working towards having recommendations for a refined program in place by 2012.

Water Supply and Demand Conditions

Based on currently allocated water supplies and continuing low levels of demands, Metropolitan projects utilizing about 790 TAF of capacity to store water in its storage programs during CY 2011. A detailed discussion of the current supply conditions is included in the April 2011 Water Surplus and Drought Management report, which is included as **Attachment 2.** Additionally, there are a number of factors that could provide additional water supplies beyond this amount. These factors include additional SWP Table A increases beyond the current 70 percent allocation, additional SWP Article 21 supplies, potential unused agricultural supplies on the CRA system, and even lower demands. These increases could be substantial, for example: A five-percent increase in the SWP Table A allocation alone, would result in approximately 100 TAF of additional supplies. Unused agricultural supplies on the CRA system, while not predictable, can also be substantial in quantity.

Metropolitan has available storage put capacity of 1.05 MAF to manage supplies if needed. This storage put capacity is being used to store the approximately 790 TAF of supplies currently available. However, some of the storage programs and locations with additional capacity beyond this amount are less desirable choices for storage management. This is because there are increased risks of future losses from those programs, potential cost implications, and concerns about future dry-year performance. When the amount of water available for storage exceeds the current estimated amount of 790 TAF, Metropolitan will be less able to effectively manage additional supplies.

Options for Managing Additional Water Supplies in Calendar Year 2011

(1) Manage Supplies with Metropolitan's Dry-Year Storage Portfolio

Under this option, Metropolitan would manage water supplies with available storage programs. Discount rate Replenishment Service Program deliveries would not be made available and the 2010/2011 Water Management

Program would not be modified and would expire June 30, 2011. Should additional supply increases occur, some amount of water may not be able to be stored for future delivery and sales.

(2) Amend 2010/2011 Water Management Program

In August 2010, the Board approved the 2010/11 Water Management Program to facilitate local storage actions by providing some protection from WSAP penalties. In December 2010, the Board approved modifications that enabled member agencies to further utilize available supplies in Southern California while being consistent with the message of efficient water use. Given the backdrop of dramatically improved supply conditions and forecasts for substantial gains in Metropolitan's regional reserves in 2011, additional discussions with the member agency managers since March 2011 have highlighted new considerations and additional modifications to the water management program.

Under this option, the following refinements to the Water Management Program would be made:

- Modify the term of the program to end on December 31, 2011, instead of June 30, 2011. This is to allow additional time for deliveries under the program.
- Charge Tier 1 full service rates for water delivered under this program between May 1, 2011 and December 31, 2011, and do not include this water in the computation of the Tier 1 annual limit for CY 2011 for each participating agency.
- Require that Metropolitan and the participating member agency agree to an acre-foot purchase amount and prepare an operating plan to estimate the monthly schedule of deliveries in advance. Deliveries will be made as system capacity and operational objectives allow, which then allows for the waiving of Capacity Charges for deliveries under the program.

A detailed description of the proposed changes to the Term Sheet of the Water Management Program is shown in **Attachment 3**.

Making water supplies available under the modified terms of the Water Management Program also provides agencies with the opportunity to purchase water supplies at a price that avoids Tier 2 and capacity charges but is not as attractive as the price offered under the discounted Replenishment Rate. Given the same budgetary or other financial constraints that the member agencies have, these changes are not likely to significantly increase the demand for replenishment water. However, the fact that the water is being sold at the Full-Service Tier 1 Rate helps to mitigate the concern that discounted replenishment water is simply replacing a Full-Service water purchase.

(3) Replenishment Service Program at a Discount Limited by Supply Increases

According to the Code, deliveries of discounted rate water for replenishment purposes may be made at the General Manager's discretion whenever both water and system capacity are available. Purchases under the Replenishment Service Program could be offered with limits under the following terms:

- Replenishment supplies must be purchased according to the terms and with the certifications outlined in the Code.
- Discount replenishment sales would be limited to increases beyond currently allocated water supplies.

Currently allocated supplies were detailed in the April 2011 Water Surplus and Drought Management Report, which is also provided as **Attachment 2** to this report. The following table shows a summary of the currently allocated supplies for 2011. Increases beyond these supplies would be the basis for available deliveries under the Replenishment Service Program under this option.

Currently Allocated Supplies Available to Service Area for 2011	
Colorado River Aqueduct	768,000
State Water Project (70% Table A Allocation)	1,739,000
Total	2,507,000

This discounted program would maximize the amount of water that can be taken, given any budgetary or other financial constraints that the agencies might have. The certification process outlined in the Code would provide verification that the water is being put into storage. Some of the issues that have been identified with the Replenishment Service Program will still exist but will be minimized as a result of the program being offered for a limited quantity of water supply.

(4) Replenishment Service Program Offered on an Ongoing Basis

Under this option, discount rate replenishment supplies would be offered similar to Option 3 above, but with no limit as to the amount or end-date. It should be noted that some of the issues that surround the current Replenishment Service Program, particularly those regarding performance and the imbalance between costs and benefits, will remain. These issues would need to be addressed in the development of a long-term Replenishment Service Program.

Cost and Revenue Discussion

The analysis of costs and benefits across options is not straightforward because it is impossible to know how much water will be purchased or moved under any of the programs. However, a calculation can be made assuming that 200,000 acre-feet of supply is made available and/or purchased under each of the options. In Option 1 where Metropolitan stores the additional supply in the dry-year storage portfolio, transportation and storage fees will be incurred but revenues will not be collected until the water is sold in the future. In the other options where water is sold to the member agencies, the primary difference between the approaches is the rate being charged for the water delivery. Under the approach to amend the Water Management Program, the rate charged would be the 2011 Tier 1 rate of $527/AF for untreated deliveries. Under the Replenishment Service Program, the discounted rate in 2011 is $409/AF for untreated deliveries. Each of the options requires that additional State Water Project water be moved and thus Metropolitan would incur the variable cost for State Water Project transportation, which is approximately $120 per acre-foot in 2011. It should also be noted that additional State Water Project deliveries will also increase Metropolitan's share of Off-Aqueduct power costs for the year. The following calculations show the Net Revenue that would result from 200,000 acre-feet of deliveries under each of the options where water is sold in this year.

Option 2 Water Management Program

SWP Cost: $120/AF x 200,000 = $24,000,000
Revenue: $527/AF x 200,000 = $105,400,000
Net Revenue: $105,400,000 - $24,000,000 = $81,400,000
Net Revenue per Acre-Foot: $527 - $120 = $407

Options 3 and 4 Replenishment Service Program

SWP Cost: $120/AF x 200,000 = $24,000,000
Revenue: $409/AF x 200,000 = $81,800,000
Net Revenue: $81,800,000 - $24,000,000 = $57,800,000
Net Revenue per Acre-Foot: $409 - $120 = $289

This analysis shows that options 2, 3, and 4 provide an avenue for moving additional water into the service area with a positive Net Revenue. The total revenue impact will be dependent on the actual quantity of acre-feet sold, but each acre-foot would provide revenues exceeding variable costs. These positive Net Revenues would go toward paying down a portion of Metropolitan's fixed costs. It is probably reasonable to assume that less water will be moved under the Water Management Program option since the cost to the agencies is higher. It should also be noted that water may be delivered in either of these options through In-Lieu means, which are generally treated water deliveries. As such, the rates charged would include the Treatment Surcharge, which includes higher revenues that the incremental variable treatment cost and would increase the positive Net Revenues shown above.

Recommendation

Staff recommends that the Board provide direction to the General Manager to offer water deliveries under the Replenishment Service Program in an amount limited to increases beyond current water supplies for this year (Option 3). This option provides an approach for managing additional amounts of water supply for CY 2011 at a water rate that should facilitate and maximize member agency local storage actions. Furthermore, the existing Replenishment Rate would collect revenues above the estimated cost of moving State Water Project supplies.

Policy

Metropolitan Water District Administrative Code Section 4512: Sales Subject to System and Water Availability

Metropolitan Water District Administrative Code Section 4514: Replenishment Service

By Minute Item 48375, dated August 17, 2010, the Board authorized the General Manager to execute Water Management Agreements.

By Minute Item 48507, dated December 14, 2010, the Board amended the terms of the Water Management Program.

California Environmental Quality Act (CEQA)

CEQA determination for Option #1:

None required

CEQA determination for Options #2, #3 and #4:

The overall project was previously determined by the Board to be exempt under the provisions of CEQA (Sections 15301, 15378(b)(2), 15378(b)(4), and 15061(b)(3) of the State CEQA Guidelines) on August 17, 2010 and December 14, 2010. A Notice of Exemption (NOE) was filed on the project at that time and the statute of limitations has ended. With the current board action, there is no substantial change proposed to the project since the previous NOEs were filed. Hence, the previous environmental documentation in conjunction with the project fully complies with CEQA and the State CEQA Guidelines. Accordingly, no further CEQA documentation is necessary for the Board to act with regards to the proposed action.

The CEQA determination is: Determine that the proposed action has been previously addressed in the August 17, 2010 and December 14, 2010 NOE (Sections 15301, 15378(b)(2), 15378(b)(4), and 15061(b)(3) of the State CEQA Guidelines) and that no further environmental analysis or documentation is required.

Board Options

Option #1

Do not approve any additional approach for delivering water to the member agencies for local storage replenishment.

Fiscal Impact: Additional water supplies that become available this year would be stored in the Metropolitan dry-year storage portfolio and incur transportation costs and storage fees with revenue or sales to occur in the future; if all supplies are able to be stored.

Business Analysis: This action provides maximum storage in Metropolitan facilities for future dry-year use but also has the highest risk of lost supplies in 2011.

Option #2

Adopt the CEQA determination and

a. Modify the 2010/11 Water Management Program Terms to extend the program through December 31, 2011.
b. Change the purchase price of Water Management Program delivered from May 1, 2011 through December 31, 2011 to the full service Tier 1 rate, and do not count these deliveries against the Tier 1 annual limit of the member agency.
c. Beginning May 1, 2011, limit deliveries certified under the Water Management Program to those related to improving local storage conditions by direct or in-lieu means of delivery. As such, procedures used for the Replenishment Service Program will be used to administer and assess program participation and performance.

Fiscal Impact: Likely increase in sales estimated to be up to 50,000 acre-feet due to program water being billed at the full service Tier 1 rates and charges (except the Capacity Charge). Water moved under this option would provide positive net revenue of $407 per acre-foot sold. To the extent that treated water is sold under this program, the Treatment Surcharge would apply and thus collect revenues to cover variable treatment cost.

Business Analysis: This action provides an avenue for local agencies to improve their local storage conditions at Tier 1 rates.

Option #3

Adopt the CEQA determination and provide direction to the General Manager to exercise his discretion to offer discounted replenishment in an amount limited to increases in supply above currently allocated supplies.

Fiscal Impact: Greater increase in sales, estimated above 100,000 acre-feet due to program water being billed at the Water Replenishment Program discounted rate. Water moved under this option would provide positive net revenue of $289 per acre-foot sold. To the extent that treated water is sold under this program, the Treatment Surcharge would apply and thus collect revenues to cover variable treatment cost.

Business Analysis: This action provides an avenue for local agencies to improve their local storage conditions at Water Replenishment Program rates. Total deliveries would be limited to increases in the current water supplies for CY 2011.

Option #4

Adopt the CEQA determination and provide direction to the General Manager to exercise his discretion to offer discounted replenishment on an ongoing basis.

Fiscal Impact: Likely increase in sales due to program water being billed at the Water Replenishment Program discounted rate. Water moved under this option would provide positive net revenue of $289 per acre-foot sold. To the extent that treated water is sold under this program, the Treatment Surcharge would apply and thus collect revenues to cover variable treatment cost.

Business Analysis: This action provides an avenue for local agencies to improve their local storage conditions at Water Replenishment Program rates.

Staff Recommendation

Option #3

4/20/2011

Deven N. Upadhyay *Date*
Manager, Water Resource Management

4/20/2011

Jeffrey Kightlinger *Date*
General Manager

Attachment 1 – Administrative Code Section 4514

Attachment 2 – Water Surplus and Drought Management Plan Report (Attachment 1 of April 12, 2011 Board Letter 8-6: Determine implementation status of Water Supply Allocation Plan 2011/12; terminate 2010/11 implementation of Water Supply Allocation Plan; and reaffirm Baseline Water Use Efficiency Condition)

Attachment 3 – Proposed Water Management Program Term Sheet

Ref# wrm12611612

Administrative Code Section 4514

Section 4514. Replenishment Service.

(a) General - The goals of the Replenishment Service program are to:

1. Achieve greater conjunctive use of imported and local supplies.
2. Encourage construction of additional local production facilities.
3. Reduce member agencies' dependence on deliveries from Metropolitan during periods of shortage.

Member agencies are encouraged to take replenishment water through a discounted rate offered by Metropolitan. This economic incentive encourages local agencies to invest in new water production, storage, treatment and transmission facilities, or to fully utilize existing facilities. These facilities are needed to augment local agencies' capability to produce local water, as well as store imported water purchased from Metropolitan during periods of abundance.

To receive the lower rates, agencies must certify to Metropolitan the amounts of imported water that they have stored in local reservoirs and groundwater basins by direct and in-lieu means. Certification forms are provided to agencies to assist in their calculations and standardize the certifications. Agencies shall comply with the administrative procedures as set forth in the most current Replenishment Service Handbook, as amended from time to time by the General Manager, to receive the Replenishment Service rate on water purchased from Metropolitan.

(b) Storage Types - Replenishment Service water shall be stored for long-term storage. Long-term storage is that water delivered by Metropolitan to a member public agency or sub-agency for storage, by direct or in-lieu methods, beyond a 12-month period. Under this concept, total annual purchases from Metropolitan increase by the amount of Replenishment Service water purchased. Water that an agency leaves in storage to replace groundwater overdraft in any previous drought year when Replenishment Service was declared unavailable is considered long-term storage.

(c) Normal Period of Availability – Replenishment Service water service shall be available between July 1 through June 30 whenever and so long as the General Manager determines that water and system capacity are available. If required for Metropolitan's system regulation, groundwater replenishment by spreading or injecting or water deliveries/sales pursuant to any storage or operating agreement, may be offered to specific member public

agencies during any time of the year at the Replenishment Service rate at the General Manager's discretion. If an agency should take Replenishment Service water when it is deemed not available by the General Manager then it shall pay the rates for that water set forth in Section 4401(a)(1). With respect to service for direct reservoir replenishment and for groundwater replenishment by spreading or injecting, service availability may be activated or terminated immediately upon notice by the General Manager to affected member public agencies. With respect to service for in-lieu groundwater replenishment or in-lieu reservoir replenishment, service availability may be activated upon notice to the member public agencies and terminated upon 48 hours notice to the member public agencies.

(d) Certification - Member public agencies may receive Replenishment Service only upon filing of the required certifications specified in Section 4507. All certifications as to the storage of water Replenishment Service must be on forms provided by the District or in electronic format acceptable to the District and provided to the District via the District's electronic certification and billing system by an authorized user. Receipt of a certification shall be considered identical to receipt of a written and signed certification binding on the member public agency for all purposes. The General Manager may make or cause to be made such investigations as the General Manager may require in order to determine the quantities of water to which the Replenishment Service rates shall apply. Such investigations may result in revisions either upward or downward in the amount of water actually received in Replenishment Service. No such investigation shall be made unless the member public agency has requested Replenishment Service and submitted the requisite certifications. The General Manager may reject any certification if the certifying agency is unable to furnish sufficient documentation as to the facts of the certification.

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Report

Water Resource Management

- Water Surplus and Drought Management Plan

Summary

This is a monthly report on developing demand and supply conditions for calendar year (CY) 2011.

On March 15, 2011, the California Department of Water Resources (DWR) increased the State Water Project (SWP) Table A allocation by another 10 percent, raising the current allocation to 70 percent. This increase is the second this calendar year following a relatively wet February and March. The 10 percent increase of SWP Table A boosted Metropolitan's SWP Table A supplies by 191 TAF. In addition, DWR also made Article 21 interruptible water available to the SWP contractors for the first time since 2007, and Metropolitan has taken delivery of about 150 TAF through the end of March 2011. Article 21 supplies are surplus flows that are periodically available in addition to the allocated Table A amounts and increases the total SWP water supplies for the year. DWR also made available the Turn-Back Water Pool for purchase. The Turn-Back Water Pool allows SWP contractors to sell and buy allocated SWP Table A water outside of their service area. Metropolitan is purchasing 8 TAF of the Pool A water. Furthermore, to prevent spilling carryover-water from CY 2010, Metropolitan took delivery of 104 TAF of SWP Non-Project Carryover water and 56 TAF of Article 14b Carryover water. Non-Project Carryover water is stored on behalf of Westlands Water District in CY 2010. Article 14b Carryover water is water that Metropolitan was not able to move in CY 2010 due to DWR system outages. In total, Metropolitan currently has a total of 2.51 MAF of supplies available to the service area from the SWP and the Colorado River Aqueduct (CRA).

In-region demands, obligations, and system losses are estimated to range between 1.72 MAF and 2.23 MAF. On the lower end of the range, the estimated demands are equivalent to CY 2010 actual demand. On the higher end, the estimated demands are based on actual January through March 2011 deliveries, full use of WSAP Level 2 member agency allocations for April through June and WSAP Baseline (no WSAP allocation) demands for July through December plus obligations to return or deliver water supply to other agencies and total system losses. For the third consecutive month, actual demands are tracking lower than WSAP levels.

Based on current water supplies and demands (WSAP allocations and 2010 actual demands), there is a range of outcomes for CY 2011. With demands at a higher end of 2.23 MAF Metropolitan will have a surplus of 280 TAF available for storage. With demands at a lower end of 1.72 MAF, Metropolitan could expect to store up to 790 TAF. Metropolitan has available storage put capacity of 1.05 MAF to manage surplus supply if needed. Although this total storage put capacity is available, some storage locations may be less desirable due to increased risk of future losses and potential cost implications. As the amount of available water to store approaches the maximum put capacity, storage management decisions may be made that reduces the effective storage put capacity for the year.

Although the year has reached a point where supplies have traditionally been stable, supply and demand conditions may continue to be variable through the year. Staff will provide updates to keep the Board apprised of any significantly changed conditions.

Supply & Demand Balance	Demand at Full WSAP Use	With 2010 Demand
Colorado River Aqueduct Available To Service Area	768,000	768,000
State Water Project Available to Service Area	1,739,000	1,739,000
Supplies Available to Service Area	2,507,000	2,507,000
In-Region Demands, Obligations, and Total System Losses	2,227,000	1,717,000
Water Balance	280,000	790,000
Storage Put Capacity	1,051,000	1,051,000

Attachments

Attachment A: WSDM Supplies for CY 2011

Date of Report: 4/12/2011

Board Report (<Water Surplus and Drought Management Plan>)

Detailed Report

This report apprises the Board of anticipated supply and demand conditions, and identifies potential actions that may be required to ensure reliability. The imported supplies shown in this report are organized to highlight the supplies and demands, obligations, and losses on the CRA and SWP. This allows for a full view of the available sources of supply anticipated for use within the service area. The balance between these supplies and the demands, obligations, and losses within the service area shows in the case of a shortage, the additional supplies or storage that would be needed. In the case of a surplus, the balance shows the amount of water that can potentially be stored. The section on storage highlights the available capacities of Metropolitan's storage portfolio.

Colorado River Aqueduct System

The table below shows the current estimate of anticipated CRA supplies for CY 2011 is 0.94 MAF. This figure is 60 TAF less than the estimate provided in last month's report. The 60 TAF of the Southern Nevada Water Authority Agreement (SNWA) water is not needed and has been removed from the list of anticipated CRA supplies since there are sufficient SWP supplies this year. CRA supplies consists of Metropolitan's Basic Apportionment (550 TAF) and all other Colorado River supplies developed to date, including water transfers that are diverted at Metropolitan's intake at Lake Havasu.

Anticipated Supplies	
Basic Apportionment	550,000
Canal Lining Water to MWD	16,000
Lower Colorado Water Supply Project	4,000
IID/MWD Conservation Program	85,000
PVID Land Fallowing	120,000
Water Exchanged with SDCWA (IID Transfer and Canal Lining)	161,000
Yuma Desalter	7,000
Total	**943,000**

Demands and obligations on the CRA system increased from 155 TAF to 175 TAF since last month's report. The 20 TAF increase of obligation reflects the increase of SWP Table A allocation for SWP contractors Desert Water Agency and Coachella Valley Water District (DWCV), which in turn increased Metropolitan's obligation to deliver water through the SWP exchange and delivery agreement with these two agencies. Other obligations comprised of delivery obligations to the Coachella Valley Water District (CVWD) as part of the Quantification Settlement Agreement, the 2008 exchange agreement with DWA and the Miscellaneous and Indian present perfected rights use. The table below lists the obligations and their corresponding quantities.

Demands and Obligations	
CVWD QSA Obligation	35,000
DWCV Table A (70 percent allocation)	136,000
DWA Exchange Agreement	1,000
Misc and Indian PPR Use	2,000
Total	**175,000**

The table below shows the total supplies and demands on the CRA System. This table reflects the obligations as mentioned above. The resulting figure of 768 TAF is the amount of water available to Metropolitan's service area without using storage.

Colorado River Aqueduct Available to Service Area	
Anticipated Supplies	943,000
Demands and Obligations	175,000
Net Storage to Service Area	0
Total	**768,000**

State Water Project System

On March 15, 2011, DWR increased the SWP Table A allocation by 10 percent, raising the current allocation to 70 percent. This increase is the second this calendar year and follows a relatively wet February and March. The 10 percent increase of SWP Table A boosted Metropolitan's SWP Table A supplies by 191 TAF. In addition, DWR also made Article 21 interruptible water available to the SWP contractors for the first time since 2007 and Metropolitan has taken delivery of about 150 TAF of the additional supply through the end of March 2011. Article 21 water is surplus flows that are periodically available in addition to the allocated Table A amounts and increases the total SWP water supplies for the year. DWR also made available Turn-Back Water Pool for purchase. The Turn-Back Water Pool allows SWP contractors to sell and buy allocated SWP Table A water outside of their service area. Metropolitan is purchasing 8 TAF of the Turn-Back Pool A water. Furthermore, to prevent spilling carryover-water from CY 2010, Metropolitan took delivery of 104 TAF of SWP Non-Project Carryover water and 56 TAF of Article 14b Carryover water. Non-Project Carryover water is stored on behalf of Westlands Water District in CY 2010. Article 14b Carryover water is water that Metropolitan was not able to move in CY 2010 due to DWR system outages.

The table below shows Metropolitan's anticipated supplies from the SWP system. Note that Yuba Component 3 Water has been removed from the table. Under this agreement, when SWP Table A allocation is above 60 percent Yuba County Water Agency is not obligated to provide Component 3 Water. The net increase from last month's report is 519 TAF. It should also be noted that the recent hydrologic conditions have improved the chances for further increases in the SWP Table A allocation.

Anticipated Supplies	
Metropolitan	
Table A (70 percent allocation)	1,338,000
Port Hueneme Agreement	1,000
SBVMWD Transfer	20,000
Article 21	150,000
MWD Turn-Back Water Pool A	8,000
SWP Non-Project Carryover	104,000
Article 14b Carryover	56,000
DWCV	
Table A	136,000
Total	**1,813,000**

Demands and obligations on the SWP totaling 74 TAF are shown below. At the current time, this is comprised of a return obligation to the Westlands Water District as part of the transfer and exchange program Metropolitan entered with them in CY 2010. The program was for a total of 111 TAF, with two-thirds of the program amount (74 TAF) due to be returned in CY 2011.

Demands and Obligations	
Westlands WD Exchange	74,000
Total	**74,000**

The table below shows the total supplies and demands from the SWP System. The resulting figure of 1.74 MAF is the amount of water available to Metropolitan's service area.

State Water Project Available to Service Area	
Anticipated Supplies	1,813,000
Demands, Obligations & Losses	74,000
Total	**1,739,000**

Board Report (<Water Surplus and Drought Management Plan>)

Storage Balances and Availability

Metropolitan has developed significant storage programs within its service area as well as on the CRA and SWP systems. Water stored in these programs can be used to augment water supplies when needed. At times when supplies exceed demands, water can be stored for future use. Metropolitan's dry-year storage totaled 1.69 MAF at the beginning of 2011, not including emergency storage of 626 TAF. Under current conditions Metropolitan does not anticipate needing to withdraw water from storage. The estimated put capacity to storage is 1.05 MAF. With the increase in SWP Table A allocation to 70 percent, Metropolitan is able to store up to 180 TAF in the SWP Carryover, a 40 TAF increase from when the SWP Table A allocation was at 60 percent. There was also a decrease in expected put capacity for several programs, including the removal of the Las Posas Program and a revision to the capacities for the Central Valley storage programs with Arvin-Edison and Semitropic. For a detailed breakdown of storage see **Attachment A**.

Dry-Year Storage Capacities	
Storage Level	1,690,000
Take Capacity	1,529,000
Put Capacity	1,051,000

In-Region Demands, Obligations, and Total System Losses

In the Metropolitan service area, total water demand is comprised of member agency demands, obligations to deliver supplies (i.e. SDCWA/IID Transfer and Canal Lining), and total system losses including those from the CRA.

Since the first implementation of the WSAP in 2009, staff has been providing water demand estimates assuming member agencies make full use of their current WSAP allocations for the first half of the calendar year, combined with an unallocated "WSAP Baseline" demand for the second half of the calendar year. This method allows for transparent adjustments on a monthly basis as actual monthly water use figures replace previously estimated figures. The method provides for a clearly defined figure that is useful when the Board is considering potential WSAP implementation for the following year. Based on this method, the estimated in-region demands, obligations, and total system losses as of the end of March are 2.23 MAF. This includes estimated demands for January through March based on actual delivery to date, WSAP Level 2 demands for April through June and WSAP Baseline demands for July through December. This figure is about 106 TAF lower than previously reported as the actual deliveries for January through March were low. Demands in CY 2010 were significantly below the allocated WSAP Level 2, and this lower level of demand may continue through CY 2011. After final accounting, the actual in-region demands, obligations and total system losses for CY 2010 were estimated at approximately 1.72 MAF.

The table below shows a range of demands from calculated WSAP allocations to last year's actual demands.

In-Region Demands, Obligations, and Total System Losses	Demand at Full WSAP Use	With 2010 Demand
Member Agency Demand	2,009,000	1,508,000
Water Exchanged with SDCWA (IID Transfer and Canal Lining)	161,000	152,000
System Losses	57,000	57,000
Total	**2,227,000**	**1,717,000**

Water Balance

Based on the current anticipated supplies from the CRA and SWP, there is a sufficient amount of water to meet and exceed both demand scenarios described above. If demand is at full WSAP use of 2.23 MAF, Metropolitan will have a surplus of 280 TAF for storage. If 2011 demands are similar to the CY 2010 demands of 1.72 MAF, there will be 790 TAF of surplus water for storage.

Board Report (<Water Surplus and Drought Management Plan>)

The table below shows that there is sufficient storage put capacity to manage the potential range of supplies available for storage. Although this total storage put capacity is available, some storage locations may be less

desirable due to increased risk of future losses and potential cost implications. As the amount of available water to store approaches the maximum put capacity, storage management decisions may be made that reduces the effective storage put capacity for the year.

Based on the supply and demand assumptions outlined in this report, the estimated end-of-year storage balance will range between 1.97 MAF and 2.48 MAF, and may increase to higher levels if additional supplies from the CRA and SWP become available and demands continue to be low.

Supply & Demand Balance	**Demand at Full WSAP Use**	**With 2010 Demand**
Colorado River Aqueduct Supplies		
Anticipated Supplies	943,000	943,000
Demands and Obligations	175,000	175,000
Colorado River Aqueduct Available To Service Area	*768,000*	*768,000*
State Water Project Supplies		
Anticipated Supplies	1,813,000	1,813,000
Demands and Obligations	74,000	74,000
State Water Project Available to Service Area	*1,739,000*	*1,739,000*
Supplies Available to Service Area	**2,507,000**	**2,507,000**
In-Region Demands, Obligations, and Total System Losses	**2,227,000**	**1,717,000**
Water Balance	**280,000**	**790,000**
Storage Put Capacity	**1,051,000**	**1,051,000**
Estimated End-of-Year Storage	**1,970,000**	**2,480,000**

Attachment A

Board Report (Water Surplus and Drought Management Plan on water supply and demand)

Projected WSDM Storage Use and Balances for CY2011 by Delivery System

2011 WSDM Storage	1/1/2011 Storage Levels	CY 2011 Take Capacity	CY 2011 Put Capacity
Colorado River Aqueduct Delivery System	**244,000**	**244,000**	**207,000**
Lake Mead ICS Account	227,000	227,000	200,000
Yuma Desalting Plant	17,000	17,000	7,000
State Water Project System	**681,000**	**561,000**	**457,000**
MWD SWP Carryover	0	0	180,000
DWCV SWP Carryover	0	0	87,000
SWP Non-Project Carryover	104,000	104,000	0
Article 14b Carryover	56,000	56,000	0
Castaic Lake (DWR Flex Storage)	154,000	154,000	0
Lake Perris (DWR Flex Storage)	65,000	65,000	0
Arvin Edison Storage Program	109,000	75,000	60,000
Semitropic Storage Program	111,000	57,000	74,000
Kern Delta Storage Program	82,000	50,000	56,000
Mojave Storage Program	0	0	0
In-Region Supplies and WSDM Actions	**879,000**	**588,000**	**273,000**
Diamond Valley Lake	638,000	459,000	172,000
Lake Mathews	139,000	61,000	43,000
Lake Skinner	40,000	6,000	4,000
IEUA/TVMWD (Chino Basin)	2,000	2,000	25,000
Long Beach (Cent. Basin)	6,000	6,000	3,000
Long Beach (Lakewood)	1,000	1,000	1,000
Foothill (Raymond and Monkhill)	1,000	1,000	2,000
Calleguas (Las Posas)	35,000	35,000	0
MWDOC (Orange County Basin)	15,000	15,000	17,000
Three Valleys (Live Oak)	1,000	1,000	1,000
Three Valleys (Upper Claremont)	1,000	1,000	1,000
Compton	0	0	1,000
Western	0	0	3,000
Cyclic - USG	0	0	0
Cyclic - PM (Three Valleys)	0	0	0
Cyclic - IEUA (Chino Basin)	0	0	0
Supplemental Storage Program (Los Angeles)	0	0	0
Other Programs	**512,000**	**136,000**	**114,000**
Other Emergency Storage	334,000	0	0
Advance Delivery Account (DWCV)	178,000	136,000	114,000
Total	**2,316,000**	**1,529,000**	**1,051,000**
Emergency	626,000	0	0
Total WSDM Storage	**1,690,000**	**1,529,000**	**1,051,000**

Term Sheet

Proposed Water Management Program ~~during 2010/11 Allocation~~ for 2011

1. **Term of Program -** Water will be available for purchase and delivery under the Water Management Program (Program) during the period from May 1, 2011 through ~~June 30~~, December 31, 2011. All water delivered prior to May 1, 2011, under the December 2010 Water Management Program (December Program) will be subject to the terms and conditions of the Program in effect as approved by the Board on December 14, 2010.
2. **Purchase Price -** The water will be billed at the time of delivery at the full service bundled Tier 1 rate and charges (i.e., readiness-to-serve charge) in effect during the month the water is delivered. Deliveries under this Program will not be applied to the participating agency's Tier 1 limit for CY 2011. Program deliveries will also not be included in the computation of the capacity charge ~~will not apply to these deliveries~~, since deliveries under the Program are interruptible.
3. **Deliveries -** Metropolitan and the participating member agency will agree to an acre-foot purchase amount and will prepare an operating plan in advance to estimate the monthly schedule for deliveries. The operating plan will be updated as needed by Metropolitan and the participating member agency to accommodate changing conditions.
4. **Administration –** Procedures used for the Replenishment Program will be used to administer and assess Program participation, unless stated otherwise in the Program terms. For the purpose of verifying in-lieu Program deliveries, a fiscal year (July 1, 2011 through June 30, 2012) assessment period will be used, even though this Program ends December 31, 2011. For in-lieu deliveries taking place under this Program during May and June 2011, an alternative assessment methodology will be developed jointly by Metropolitan and the participating member agency.
5. **Effect on Water Supply Allocation -** The water will not count toward the participating member agency's allocation when it is delivered.
6. **Certification –** Member agencies must certify deliveries under the Water Management Program. Certifications must be complete within six months of the month in the which water is delivered.