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

MEMBER AGENCIES

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

OTHER REPRESENTATIVE

County of San Diego

August 16, 2012

Gary Breaux
Chief Financial Officer
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

Re: Rate Refinement Workshop

Dear Gary,

I wanted to give you some of my thoughts on the issues the rate refinement board workshop should include on MWD's finance plan and water rates. The "big picture" was described in the July 9, 2012 letter the San Diego board members sent to Chairman Foley requesting the workshop. That letter included concern for MWD financial stability given the high fixed costs versus low fixed revenues and questions how MWD will ensure sufficient revenues to pay its future costs and avoid stranded investments. Chairman Foley indicated that a workshop would be held. To assist in your preparation for the workshop, I went back through some of the other letters we have written to MWD on issues of concern and I thought it might help you to provide a short list of some of the key questions.

1. How can MWD execute a long term contract for the BDCP unless it has an assured source of revenue to make the payments?
2. Are ad valorem tax increases on a regular basis a real possibility? If so, what steps need to be taken to advance that approach? And, could this be the realistic solution to fund the BDCP?
3. Will the member agencies agree to sign take-or-pay contracts? If not, isn't MWD being asked to carry all of the risk of stranding the BDCP and other investments? Is that a reasonable risk for our board to agree to assume?
4. What will happen if MWD's sales continue to decline at the same time we continue to embark on new projects? How will MWD's liabilities be paid? What legal mechanism exists to recover stranded costs? Will MWD be required to sign so-called "step up" agreements on the remaining ratepayers could have to cover if the other State Water Contractors default?
5. Are peaking costs being adequately charged and collected under the current rate structure? With so many MWD costs being incurred to meet dry-year peaking demands (not just for treated water), what mechanisms can MWD put in place in order to send the right price signal to ensure that agencies generating peaking costs are in fact paying those costs? Our calculations show that the current capacity and RTS charges do not fully recover these peaking costs.
6. In light of reduced sales projections, does it make sense for MWD to continue to pay its member agencies to NOT buy MWD water?

7. Given that the 20% by 2020 requirement is a retail requirement, and that MWD sales are down by more than 30%, does it make sense for MWD to continue to make current investments in water conservation? Or, should it defer those investments until sales begin to improve? Why hasn't our adaptive IRP adapted to reduced sales?
8. If MWD is going to make additional investments in water conservation, shouldn't it reduce the amount of money it is spending on other water supplies by a like amount?
9. How will MWD ensure that its revenues are in fact sufficient to meet its operating expenses over the next five years? At my local agency at Padre Dam, we call this "living within the household budget". That is to say that expense is reduced to match the long term revenue stream, not the reverse.
10. What are the risks associated with projecting water sales based on "average" pricing? Will groundwater agencies buy as much water from MWD if it isn't discounted? Will other agencies pay more in order to subsidize discounted water sales especially as agencies develop new local supplies reducing their dependence on Met?
11. Given all of the changed circumstances, including the increasing cost of MWD water, is it reasonable to rely on historical data in projecting future water sales?

There are other issues and questions but this is a pretty good list of the issues I see that the Water Authority has raised over the past couple of years. We look forward to working with you and our fellow board members to ensure MWD's future and long term fiscal sustainability.

Sincerely,

Doug Wilson
Director
Attachments (without original enclosures):

1. July 9, 2012 re: Update on Rate Refinement Discussions
2. July 22, 2012 re: Board item 8-3 (LRP)
3. May 7, 2012 re: Board item 8-4 (conservation program)
4. March 21, 2012 re: Recommendation to cap MWD rate increases at 3%
5. March 12, 2012 re: LRPs
6. February 13, 2012 re: Board item 8-2 (draft remarketing statement)
7. February 3, 2012 re: Biennial budget
8. December 13, 2011 re: SB60
9. November 4, 2011 re: Board item 8-8 (discounted replenishment program)
10. October 25, 2011 re: KPMG audit report
11. October 7, 2011 re: WP&S items
12. August 22, 2011 re: Draft official statement
13. August 16, 2011 re: Member agency willingness to sign take-or-pay contracts
14. May 6, 2011 re: Board item 5-2 (sale of discounted water)
15. December 9, 2010 re: Draft official statement
16. September 22, 2010 re Draft official statement

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OTHER REPRESENTATIVE
County of San Diego

July 9, 2012

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

RE: Update on Rate Refinement Discussions (Finance & Insurance Committee Item 7-a)

Dear Mr. Foley:

We have reviewed the PowerPoint presentation to the Finance & Insurance Committee, item 7-a, July 9, 2012 RE Update on Rate Refinement Discussions (the PowerPoint). After waiting more than five years – since the Long Range Finance Plan (LRFP) subgroup of member agency managers was formed in mid-2007 to discuss Metropolitan's Long Range Finance Plan and "Rate Refinement" – we believe the recommendations described in the PowerPoint fail to address the right priorities or solutions for Metropolitan.

Metropolitan's revenues have been insufficient to pay its expenses in five out of the last six years. Revenue stability and certainty should be a priority, and we agree with the belated conclusion now reached by Metropolitan staff and the member agency managers that the use of purchase orders has failed to meet this board objective over the past ten years. During this time, Metropolitan's fiscal stability has continued to deteriorate. "Use of the current rate structure" (however that is defined) will not address Metropolitan's need for revenue stability and cannot be relied upon to ensure that there will be a source of revenue for the multi-billion investments in the Delta and otherwise that Metropolitan is planning to make.

Rather than accepting the narrow "priorities" identified by staff and the member agency managers, we request that a board workshop be scheduled as part of next month's Finance & Insurance Committee meeting to consider the elements and priorities of a Long Range Finance Plan for Metropolitan – a plan that is now long overdue. Metropolitan should not continue to spend money on water supply projects without evidence describing the need for these projects, and its member agencies unwilling to pay for them over the long term. We ask that the subject of take-or-pay contracts be considered by the board of directors, along with any and all other proposed alternatives to reasonably ensure Metropolitan's recovery of sufficient revenues to pay its future costs and avoid stranded investments.

At a workshop, the board could consider all issues associated with a Long Range Finance

Plan, including whether there is any support for ad valorem tax increases and any staff proposals to address the appropriate allocation of all standby service costs (not just treated water). We have distributed to the managers and attach to this letter a slide that depicts projected dry-year peaking by the Los Angeles Department of Water and Power, based on its Urban Water Management Plan. The staff's recent recommendation that all member agencies "share" this cost is not acceptable to the Water Authority because these costs are required to be charged to and paid by the member agencies that benefit from Metropolitan's expenditures to provide this service. The Water Authority expects to pay the costs associated with its own peaking – as all agencies should – but cannot and will not ask our ratepayers to "share" the costs of providing service to other agencies.

We ask that the board of directors take this issue up at the proposed workshop along with all other issues proposed for consideration by members of the board.

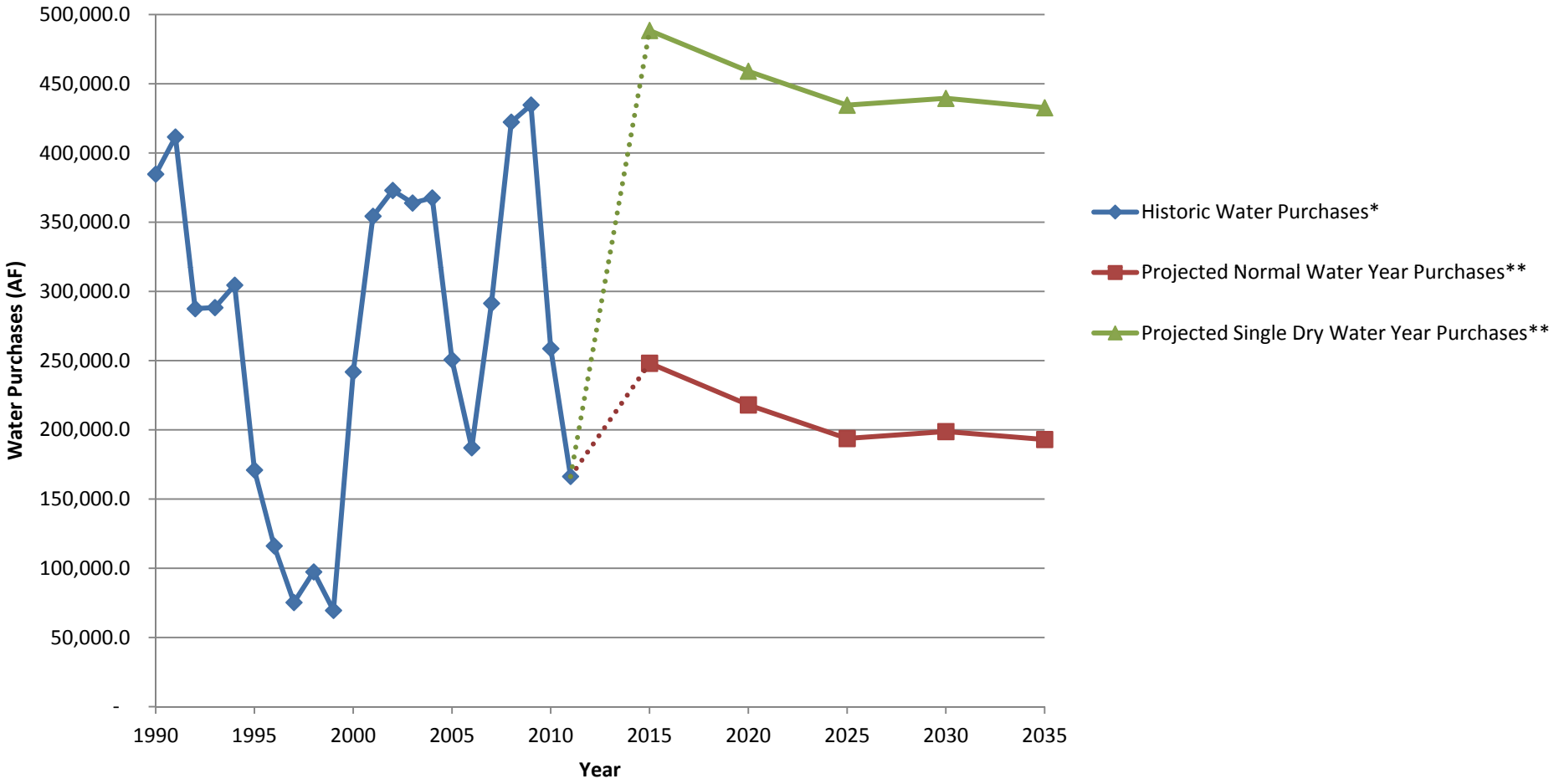
Sincerely,

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

cc: Metropolitan Board of Directors

Attachment: LADWP Historic & Projected Water Purchases from MWD

LADWP Historic & Projected Water Purchases from MWD



*Source: MWD Online Operations (1990-2007) and WINS Table A Report (2008-2011)
**Source: LADWP 2010 Urban Water Management Plan

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June 11, 2012

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

MEMBER AGENCIES

Carlsbad Municipal Water District
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OTHER REPRESENTATIVE

County of San Diego

Re: Board Item 8-3 -**OPPOSE**
Authorize entering into a Local Resources Program agreement with Municipal Water District of Orange County and the city of San Clemente for the San Clemente Recycled Water System Expansion Project. (WP&S)

Mr. Foley and Members of the Board,

The Water Authority OPPOSES Board Item 8-3 on the following grounds:

Under California law including Proposition 26, MWD is required to set water rates that do not exceed the reasonable costs of providing the particular service for which the rate is charged, and that are equitable, fair and non-discriminatory. MWD has failed to present in Board Memo 8-3, by reference to its outdated Integrated Resources Plan (IRP), even more outdated 2007 LRP "target" or otherwise, any showing that MWD's payments for this local water supply project will benefit any ratepayers other than those of the city of San Clemente, which will own the water supply. There is no demonstration that any water supply or transportation costs are avoided by MWD as a result of these payments. The bald assertion in Board Memo 8-3 that, *"the project would strengthen regional water supply reliability"* is insufficient to meet the requirements of California law.[i]

Far from benefitting ratepayers of other member agencies, MWD's continued payment of these subsidies under current circumstances *harms* all other MWD water ratepayers by further reducing demand for MWD water, thereby reducing MWD's own revenues and driving up the cost of its water purchased by customers of other MWD member agencies. Moreover, MWD staff's continued recommendations to approve subsidy agreements is inconsistent with its own actions months ago to suspend its "Local Resource Development Strategy Task Force" in order to reexamine the merits of the program and the water demand projections upon which it is based.

MWD's expenditures have exceeded its revenues in three out of the past four years[ii] because water sales are down by more than 30% since the 2010 IRP was adopted, let alone the 2007 LRP "target" for local resources development. Rather than respond to these changed circumstances (consistent with the IRP's articulated "adaptive management"), MWD is consciously choosing to rely on outdated water supply and financial planning that assume bloated water demands that do not exist and are not reasonably projected to exist in the foreseeable future.

In addition to these grounds, the Water Authority objects to being charged a "Water Stewardship Rate" (WSR) to pay for this project because its ratepayers have been barred by the MWD board's August 2010 action from receiving any WSR benefits. Accordingly, the WSR is discriminatory, violates California law and may not be collected from the Water Authority's customers.

As part of the lawsuit it has filed challenging MWD's 2013 and 2014 water rates, the Water Authority is seeking to be relieved of any financial responsibility for this and other WSR projects approved by the MWD board of directors, so that the agencies that do not object may pay for these projects. As stated previously, the Water Authority has no objection if other MWD member agencies want to "pool" their money, however, that activity must be voluntary and not part of the water rates imposed by MWD on the ratepayers of all of its member agencies.

Sincerely,

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

cc: Jeff Kightlinger, MWD General Manager
San Diego County Water Authority Board of Directors and Member Agencies

---

[i] Attachment 3 to Board Memo 8-3 states in a footnote that, "IRP studies show reduced long-term costs to the region when local resources are developed due to downsizing or deferral of Metropolitan's capital improvements, reduction in operating costs for importation, treatment and distribution, and reduction in costs for developing alternative regional supplies. These benefits are realized by all Metropolitan member agencies through improved regional water supply reliability." However, there is no evidence to support this broad claim, which is insufficient in any case to meet the requirements of California law including but not limited to Proposition 26.

[ii] See February 14, 2012 Board Letter 8-2, page 60, note 5.

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OTHER REPRESENTATIVE
County of San Diego

May 7, 2012

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

Re: Board Memo 8-4 – OPPOSE
Authorize changes to water conservation incentives (subsidies) as described

Dear Mr. Foley:

The Water Authority and its member agencies have a long and proud record of leadership in water conservation planning and implementation, based on strategic initiatives that will continue to reduce the region's reliance on imported water supplies at an affordable cost. Given MWD's role as a supplemental wholesale water provider – and taking into account the state mandate for 20% water conservation by 2020 at the retail level – the San Diego delegation does not support Agenda Item 8-4, to provide additional "incentives" to encourage water conservation. We have written to you and the board many times on this subject (reference to past correspondence is included below but not attached), so we provide only the following brief summary of the basis of our analysis.

Due to reduced demand for MWD water – and associated higher water rates – there is no need for MWD to pay subsidies to encourage water conservation at the wholesale level. Water sales are already down at MWD by more than 30%. When sales are reduced, water rates go up as ratepayers are forced to pay more for using less water. As outlined in our March 21 letter to you and the rest of the board, it is time to stop punishing water use efficiency efforts by Southern California ratepayers who are already paying for water use efficiency programs at the retail level to meet the 20x2020 mandate.

The Water Stewardship Rate which is collected to pay for MWD conservation subsidies violates California law. The Water Stewardship Rate does not fairly apportion or reflect the actual, reasonable and proportionate costs of the services for which the rate is imposed. The Water Stewardship Rate violates the legal requirements of MWD's principal act, Proposition 13 and the statutes implementing it, Government Code § 54999.7, the California common law of utility rate-making and Proposition 26. The Water Authority has provided MWD with detailed analyses by expert consultants establishing that the Water Stewardship Rate is legally defective.

The so-called "Rate Structure Integrity" clause adopted and imposed on the Water Authority by the MWD board of directors precludes any possible benefit to San Diego ratepayers from many MWD conservation programs. The board memorandum does not disclose that San Diego ratepayers are precluded from participating in MWD subsidy programs to the same extent as other MWD member agencies. We request that you include information in future board memoranda to fully disclose that information.

From a water resource planning, budget and policy point of view, we strongly encourage MWD to develop and implement a water conservation program that is better suited to its role as a wholesale water provider, that is based upon a calculable demonstration of need and avoided water supply cost (e.g., reduced take from the Delta, elimination of subsidies for member agency seawater desalination, etc.). Unfortunately, rather than viewing water use efficiency as a key part of its water resource plan and cost containment strategy – as recommended by the Water Authority for many years and by NRDC in its April 6, 2012 letter to you – MWD continues to limit itself to subsidy programs that are more appropriate at the retail level where the statewide conservation mandate has been imposed.

Sincerely,

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

cc: Ed Osann, NRDC Senior Policy Analyst

Past correspondence to MWD RE water conservation programs and subsidies:

- August 16, 2010 letter on MWD staff analysis on opt-in/opt-out conservation program
- November 29, 2010 comments on MWD draft Long Term Conservation Plan (LTCP)
- July 20, 2011 comments on LTCP working draft Version 11
- August 15, 2011 letter opposing LTCP and revised policy principles
- November 13, 2011 letter RE turf replacement grant

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March 21, 2012

John V. Foley, Chairman
and Members of the Board of Directors
Metropolitan Water District of Southern California
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Los Angeles, CA 90054-0153

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OTHER REPRESENTATIVE

County of San Diego

Re: Recommendation to Cap MWD Rate Increases at 3% for 2013 and 2014

Dear Mr. Foley and Members of the Board,

We were disappointed that the majority of the MWD board of directors did not feel that it would be productive to meet together as a board to discuss approaches to lowering MWD's proposed rate increases for 2013 and 2014, in advance of our board vote in April. As a result, we are submitting this letter to you and all members of the board for consideration prior to the April 10 board meeting.

RECOMMENDATION

We recommend that the board cap MWD "average" rate increases[1] at 3% for 2013 and 2014. We believe this can be accomplished – without any reduction of capital spending to maintain the Colorado River Aqueduct or any other MWD infrastructure – by reducing MWD's Operations and Maintenance (O&M) expenditures by 10% and suspending conservation funding for the next two years. These changes would reduce the proposed two-year budget by $116.5 million and allow the "average" rate increases to be capped at 3% or less in 2013 and 2014.[2]

Our recommendation would also direct staff to return to the board with specific budget reductions to accomplish the minimum 10% reduction in O&M (or, $76.5 million in expenditures over the two years – without changing the scheduled OPEB funding).

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[1] No one pays an "average" water rate at MWD – for example, MWD's proposed Tier 1 Treated water rate increase for 2013 is 9.3%, and its Tier 1 Untreated water rate increase is 8.6%.

[2] Staff indicated previously that in order to reduce the rate increase from 7.5% for 2013 and 5% for 2014, to 5% for both years, it would need to cut expenditures by $26.4 million over the two year period. Based on this formula, we assume that cutting expenditures by $116.5 million (more than 4 times $26.4 million) would allow the rate increases for both years to be held to 3% or less. If this assumption is incorrect, then we ask that MWD staff provide the board with the amount of the budget reduction necessary to hold rates to 3% or less over the next two years.

BACKGROUND

In its budget and recommended "average" proposed water rate increases of 7.5% and 5% for 2013 and 2014, respectively, MWD staff proposed to *increase* the O&M budget by $15 million in 2013 and $22.5 million in 2014, including higher travel expenses, staffing levels and consulting services. This budget proposal *increases* MWD's O&M budget by $52.5 million over the two years, and includes staffing increases of at least 42 or as many as 80 new employees.[3]

In response to board member requests to lower the first year "average" rate increase to 5%, staff recommended a mix of reduced expenditures ($14 million and $13 million, respectively for 2013 and 2014), reducing Central Valley storage funding and $5 million per year reduction of conservation funding or other cuts of similar magnitude.

Staff's recommended budget is inconsistent with MWD water sales and revenue trends, discussed below. It is also out of step with cities and other public water suppliers throughout Southern California that have been forced to make the difficult decisions to reduce expenditures as a result of declining revenues. Rate increases to support expanded budgets, including more staff and increased spending, ignore the economic realities our water ratepayers are facing. Budget reductions should target reduced spending rather than water supply programs such as the Central Valley storage funding.

DISCUSSION AND OTHER CONSIDERATIONS

<u>Protection of Colorado River Aqueduct and Other Infrastructure</u> – We agree it is important to maintain MWD infrastructure investments, including the Colorado River Aqueduct. *That's why our proposal would leave intact all capital spending as proposed by staff.* But as we all know, repair and replacement of aging infrastructure is not the "No. 1 driver" of MWD's proposed water rate increases.

<u>Stop Punishing Water Conservation by Southern California Ratepayers</u> – Water ratepayers across the Southland have responded to our call to reduce water usage over the past few years. Now, water ratepayers do not understand – and they are angry – that they are being asked to pay more for using less water.[4] In fact, reduced demand for MWD water is the *principal reason* MWD's rates have risen 75% since 2006, and the principal reason why MWD's expenditures have

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[3] MWD's January budget document states that it includes a total authorized personnel complement of 1,907 (including 24 temp equivalents) for 2012/13 and 2013/14, with an assumed vacancy rate of 2.7% and 2.9%, respectively. This translates to 1,832 and 1,828 FTE for each of the two years, respectively. But staff reported to the board in February that it had 1,756 employees on its payroll – which would mean that MWD intends to hire 80 additional staff. A subsequent report by staff at the February board meeting said that applying the vacancy rate would result in 1,798 full time equivalents (exclusive of temps), which would mean that MWD intends to hire 42 additional staff.

[4] See, for example, San Diego County Grand Jury Report*, San Diego County Water Rates: High Today, Higher Tomorrow* at http://www.sdcounty.ca.gov/grandjury/reports/2010-2011/WaterRatesFinalReport.pdf This concern is being raised in retail water rate-setting proceedings across Southern California.

exceeded revenues in three of the last four fiscal years.[5] However difficult it is to explain to water ratepayers, we all know that fixed costs are not reduced with reduced sales – and, that it is essential that fixed costs be paid. But MWD's proposed rate increases go far beyond covering fixed costs – the budget actually *increases* spending on projects that are *not necessary* at this time of reduced demand for MWD water.[6]

This is why we recommend that conservation funding for the next two years be suspended.[7] While we understand the popularity of these programs, these expenditures are simply not necessary to "incentivize" water conservation at a time when water sales are already down more than 30% at MWD and most retail water suppliers. Retail ratepayers are already being asked to fund the difference between fixed costs and the amount of revenue available from reduced sales. It isn't fair – or even logical – to also ask our ratepayers to pay for even more water conservation right now – they need and deserve to take the "break" that suspension of these payments would provide in the form of lower water rates.[8]

<u>Renewed Call for Moratorium on Use of MWD Ratepayer Dollars to Pay for Member Agency Water Projects</u> – MWD has also been relying on its outdated Integrated Resources Plan[9] and unrealistic water sales projections to support its continued payment of MWD water ratepayer dollars to subsidize member agency water supply projects. These projects are not owned or operated by MWD, and MWD has no right to the water supply. MWD has failed to demonstrate that these payments benefit the customers of any member agency other than the agency receiving the payments.[10] The bald statement that these projects "will strengthen regional

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[5] February 14, 2012 MWD Board Letter 8-2, page 60, note 5 and attached Remarketing Statement.

[6] Staff continues to rely on an outdated Integrated Resources Plan (IRP) and unrealistic sales projections to support its expenditures.

[7] We note that although MWD continues to budget conservation at $20 million annually, its actual expenditures are significantly less. This is all the more reason to eliminate this spending from the proposed budget.

[8] MWD should continue its conservation program except for the payment of financial subsidies. The Water Authority supports increased water conservation as part of a sensible, long-term plan that takes water rate impacts into account. Ratepayers are already highly motivated to conserve water due to higher water prices. MWD should not pay for state-mandated conservation requirements at the retail level. See Director Steiner's August 15, 2011 letter to Mr. Foley re: Board Memo 8-7 – Adopt the Long Term Conservation Plan and revised policy principles on water conservation – OPPOSE. Finally, the Water Authority would support increased conservation investments by MWD – now and in the future – that are based upon a calculable demonstration of need and avoided water supply cost (e.g., reduced take from the Delta).

[9] See Director Steiner's October 11, 2010 letter to Chairman Brick re: Adoption of the 2010 Integrated Resources Plan – OPPOSE and attachments. MWD's IRP is not a useful or realistic planning tool and cannot be relied upon to assess the need for water supply investments by MWD (and thus the benefits to MWD's customers). Although the IRP stated that it would rely upon "adaptive management" to adjust to changed circumstances, *MWD has failed to adapt* to the fact that its water sales are down by more than 30%. MWD has also consistently failed to inform the public about the rising cost of water or include in its own planning the likely impact of higher water costs on demand for MWD water.

[10] If the Water Authority is successful in its challenge of the Water Stewardship Rate to pay for these water supply projects, the costs will be redistributed to all other MWD member agencies and fall

water supply reliability," absent a substantial factual basis and analysis connecting the facts to the conclusion, is insufficient to support MWD spending under Proposition 26 or other legal requirements.

Stop Underwriting Peaking Costs of Los Angeles and Other Agencies – The Water Authority has calculated that the annual benefit to the City of Los Angeles Department of Water and Power under the current MWD rate structure – resulting from MWD's failure to identify and allocate the costs of annual peaking – is $35 million to $40 million *per year*. *The Water Authority is not the only agency underwriting these costs – ratepayers from Orange County, Ventura County, Riverside County and San Bernardino County are also paying for LA's annual peaking.* This is because the current rate structure fails to account for the costs associated with annual peaking, including the cost of water, distribution and storage capacity necessary to serve these sporadic annual demands.[11]

Many agencies, including the Water Authority, have *some* annual and seasonal peaking that is not accounted for in MWD's cost of service. These costs should be identified and charged to the agencies that are benefitting from the investments necessary to meet their water supply needs. We raised this issue in our February 3, 2012 letter to Business and Finance Committee Chairman Grunfeld, copied to MWD's General Manager and Chief Financial Officer (copy attached). Nearly one month later, on March 6, 2012 – after the budget workshops had already been concluded – we received a response from the CFO that did not address the substance of this issue, but stated that, the issue "is worded as a statement or position and should be addressed through the Board or Committee process" (copy attached). On March 8, we responded to the CFO's letter, again presenting this issue in the form of a question. We asked,

> Does the MWD cost of service currently capture and charge to the agencies that benefit, the full costs of system "standby" capacity and supply that enables year-to-year (annual) peaking off MWD?

We still have not received a response from the CFO, from MWD management or from the Chairman of the Board or Chairman of the Business and Finance Committee. *Properly assigning these costs would result in additional water rate reductions for many ratepayers throughout MWD's service area.* We ask that you support our request at the April board meeting that this issue be addressed through the board or committee process, as suggested by the CFO – and, that adoption of *rates* be deferred until the board receives a full explanation why these costs are not accounted for or properly assigned in MWD's cost of service. By copy of this letter, we are also

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disproportionately on the agencies – and their customers – that have not been rewarded with rich subsidy contracts.

[11] Staff's February 17, 2012 presentation to the Member Agency Managers on the Proposed Biennial Budget, Revenue Requirements, and Water Rates and Charges Fiscal Years 2012/13 and 2013/14, slide 7, is incorrect. While it correctly states that additional physical capacity must be designed into the system and additional capital costs are incurred, and that these costs include portions of distribution and regulatory storage, it is incorrect in its statement that MWD's capacity charge "recovers the costs of the system used to meet peak demands." This is not accurate even as to seasonal peaking, let alone annual peaking, *which is not accounted for in MWD's cost of service allocations.*

asking the General Counsel to advise us, in writing, whether she agrees with the CFO that the MWD board has the option, as a "policy" matter, to *not charge the cost of the services*, *facilities and supplies attributable to annual peaking to the agencies that benefit.*

SUMMARY

We urge the board to adopt a budget that caps the "average" rate increases at 3% for 2013 and 2014. Further, we recommend that the adoption of water rates and charges be deferred until MWD management has provided a cost of service analysis that properly accounts for and assigns all MWD costs – including the cost of annual peaking – to the agencies that benefit.

Sincerely,

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

Attachments:

1. Water Authority's letter to MWD re biennial budget dated February 3, 2012
2. MWD response to Water Authority's comment letter dated March 6, 2012
3. Water Authority's response to MWD letter dated March 8, 2012

cc: Jeff Kightlinger, MWD General Manager
Gary Breaux, MWD Chief Financial Officer
Marcia Scully, MWD General Counsel
San Diego County Water Authority Board of Directors

San Diego County Water Authority
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MEMBER AGENCIES

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Helix Water District
Lakeside Water District
Olivenhain Municipal Water District
Otay Water District
Padre Dam Municipal Water District
Camp Pendleton Marine Corps Base
Rainbow Municipal Water District
Ramona Municipal Water District
Rincon del Diablo Municipal Water District
San Dieguito Water District
Santa Fe Irrigation District
South Bay Irrigation District
Vallecitos Water District
Valley Center Municipal Water District
Vista Irrigation District
Yuima Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

March 12, 2012

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

Re: Oppose Local Resources Program Agreements – Board items:
7-4 – LADWP Chevy Chase Park and Los Feliz Golf Course
8-6 – LADWP Harbor Industrial Project
8-7 – LADWP Hansen Dam Golf Course
8-8 – LADWP Griffith Park
8-9 – Eastern MWD Landscape Irrigation
8-10 – West Basin MWD Seawater Barrier and Landscape Irrigation

Mr. Foley and Members of the Board,

We have reviewed the staff reports recommending board approval of six funding agreements under the Local Resource Programs (Board items 7-4, 8-6, 8-7, 8-8, 8-9, and 8-10). We oppose the use of MWD regional water ratepayer dollars to pay for these local supply projects of these member agencies, on the following grounds.

1) Preparation of the underlying data and cost of service and rate structure proposal purporting to justify these payments is the product of a broken governmental process, all as described in detail in the submittals the Water Authority has presented at the public hearing on MWD's proposed water rates and charges for 2013 and 2014. As presented at the public hearing earlier this morning, the agencies that are the principal beneficiaries of these programs are draining millions of dollars from the pockets of water ratepayers in other cities and regions in favor of their own.

2) There is no credible basis established by the board memoranda or otherwise to support these payments. The mere statement that, *"the project(s) would strengthen regional water supply reliability"* is wholly insufficient to support the use of regional ratepayer dollars to pay for these agencies' local water supply programs. Nor are these payments supported by any demonstration in the board memoranda or otherwise that these payments benefit anyone but the individual agencies to which payments are being made. There is no demonstration that any water supply or transportation costs are avoided by MWD as a result of these payments.

3) To the contrary, these payments harm all MWD water ratepayers by further reducing demand for MWD water and the revenues MWD depends upon for its very existence, and thus driving up the cost of MWD water supply for all other water ratepayers. MWD's expenditures have

exceeded its revenues in three out of the past four years.[1] MWD's lower sales are driving up the cost of water. Customers are angry because they are being asked to pay more at the same time they are using less. Rather than respond to these circumstances, MWD is further exacerbating the situation by paying some of its member agencies to buy even less water. MWD's continued reliance on an outdated Integrated Resources Plan that includes bloated water demands that clearly do not exist – and are not reasonably projected to exist any time in the near future, if ever – is an insufficient basis to justify these payments.

4) As of August 2010, the MWD board took action stating that the Water Authority is no longer eligible to receive funds collected through its Water Stewardship Rate. As a result, and because no other direct or indirect benefit to the Water Authority and its customers is demonstrated, the rates and charges violate California law and may not be collected from the Water Authority's customers.

5) Staff's recommendation to the board to approve these projects is inconsistent with its own action in the *public member agency process* to suspend further discussions with the Local Resource Development Strategy Task Force, in order to reexamine the merits of this program and the water demand projections upon which it is based. Until that examination is completed, consideration of all local resource projects should be suspended.

6) The board memoranda proposing funding for these projects are insufficient to inform the board of directors of the costs associated with these projects. For example, Board Letter 8-9 (Eastern Municipal Water District) states that MWD's share of the cost will be $2.3 million, but that it could go up to $31.3 million – almost 14 times higher. Similarly, Board Letter 8-10 (West Basin) states that the financial impact to MWD is $7 million, but that it could go up to $50 million – more than 7 times higher. The board has no way of knowing based on the Board Letters what the benefits and risks are, or what MWD's financial exposure in connection with these projects will be.

The Water Authority would have no objection if the other MWD member agencies and the cities and customers they serve wish to subsidize the local water supply projects of the City of Los Angeles and other large agencies benefitting from this program. However, if they wish to do so, a separate fund that they pay into should be created for that purpose.

Sincerely,

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

cc: Jeff Kightlinger, MWD General Manager

[1] See February 14, 2012 Board Letter 8-2, page 60, note 5.

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February 13, 2012

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

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OTHER REPRESENTATIVE

County of San Diego

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

MEMBER AGENCIES

Carlsbad Municipal Water District
City of Del Mar
City of Escondido
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Yuima Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

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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December 13, 2011

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

MEMBER AGENCIES

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OTHER REPRESENTATIVE

County of San Diego

Re: SB 60 Annual Public Hearing and Report to the Legislature Regarding Adequacy of MWD's Urban Water Management Plan
REQUEST TO INCLUDE INFORMATION IN REPORT TO LEGISLATURE

Dear Chairman Foley and Members of the Board of Directors:

We request that this letter and all of its attachments be made a part of today's board record and included in MWD's Annual Report to the Legislature regarding the adequacy of MWD's Urban Water Management Plan to achieve increased emphasis on cost-effective conservation, recycled water and groundwater recharge as described in the MWD Act.

As background to yesterday's public hearing on this subject, the Water Authority prepared and submitted to MWD a short PowerPoint presentation that was not allowed by Mr. Kightlinger to be shown to the board of directors. MWD staff also refused to distribute hard copies of the presentation to the board in accordance with the usual practice as stated on the speaker's request form; because of these refusals, San Diego Director Lewinger distributed the copies. We were not aware at the time of the hearing that the Water Authority's PowerPoint had already been loaded on the MWD computer, or we would have objected at that time. Water Authority staff was also informed yesterday that no presentations may be made to the MWD board unless they are first reviewed and approved by MWD management. We do not believe that MWD may place any such prior restraint on the content of material proposed to be presented at any public meeting of the MWD board of directors. As Chair, you undoubtedly know that the Brown Act expressly states that "a local agency shall not prohibit public criticism of the policies, procedures, programs, or services of the agency, or the acts or omissions of the legislative body." (Government Code § 54954.3 (c).)

Copies of the Water Authority's PowerPoint presentation, written testimony by Assistant General Manager Dennis Cushman and a report by Gordon Hess and Associates titled, *Comparison of MWD Demand Projections, Member Agency UWMPs and Local Water Supply Development Plans* (Hess Report), are attached. As you know, for the reasons described in Mr. Cushman's testimony and attachments, we believe that MWD focused on the wrong question at yesterday's public hearing and in its draft Report to the Legislature by limiting it to a report on MWD subsidy programs.

We also request that MWD inform the Legislature about its "Rate Structure Integrity" (RSI) "policy" and clause, which may be used by MWD to terminate all MWD funding agreements for conservation, recycled water and groundwater recharge in the event that agency challenges MWD's water rates in court or before the Legislature. Further, MWD should include in its SB 60 report that the MWD board has, in fact, terminated, with limited exception, all of the Water Authority's funding agreements that contain the RSI provision, and refused to enter into future funding agreements supporting conservation, recycled water and groundwater recharge in San Diego County. (A copy of MWD's June 23, 2011 to the Water Authority is attached.) MWD has essentially blackballed the Water Authority from participation in these programs, in spite of the fact that it continues to collect more than $16 million annually from San Diego County water ratepayers to pay for these programs. MWD should also inform the Legislature that the Water Authority is challenging MWD's actions and the constitutionality and legal propriety of the RSI clause in the lawsuit now pending in Superior Court in San Francisco.

For the reasons described in Mr. Cushman's testimony and in the Hess Report, we do not believe that MWD has done the analyses necessary – either in its 2010 Integrated Resources Plan (IRP) or 2010 Regional Urban Water Management Plan (RUWMP) to support and enhance water conservation, recycled water and groundwater recharge in Southern California. Indeed, the greatest impediment may be the very perpetuation of the notion that these projects will only be developed if MWD subsidizes them. Conservation is at an all-time high throughout the Southland as a result of the higher water rates being charged by MWD and its member agencies. More local water supply projects are being developed because they have become cost-competitive due to the higher water rates being charged by MWD. It is clearly time for a fresh and realistic look at MWD's demand and rate projections and to tie future resource planning directly to the willingness and firm financial commitment of its member agencies to pay.

Sincerely,

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

cc: MWD Board of Directors
Jeff Kightlinger, General Manager
San Diego County Water Authority Board of Directors

Attachments:

1. Water Authority's PowerPoint Presentation to MWD WP&R dated December 12, 2011
2. Water Authority Assistant General Manager Dennis Cushman's testimony
3. Comparison of MWD Demand Projections, MWD Member Agency UWMP's and Local Water Supply Development Plans, prepared by GH&A, Inc. December 2011
4. MWD June 23, 2011 letter to Water Authority

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OTHER REPRESENTATIVE

County of San Diego

November 4, 2011

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

Re: Board Memo 8-8 –
Approve Policy Principles for a Replenishment (Discounted Water) Program

Dear Chairman Foley,

Board Memo 8-8 asks the board to approve policy principles to guide the development of a new program for the sale of discounted water. We do not believe that the policy principles as proposed by staff provide a sufficient and clear basis to guide the development of a new program. Indeed, we do not believe that the staff has established the need for a new program to sell discounted water, whether it is described as "replenishment," "regional water management," or otherwise.

We have raised a number of questions over the past several months, since the General Manager first proposed the sale of discounted water last April. Our concerns have focused on the unprecedented budgetary and fiscal challenges confronting Metropolitan, including the fact that its expenditures have exceeded revenues in six out of the last nine years. Over the last four years, Metropolitan has resorted to raiding funds intended for pay-as-you-go capital expenditures in order to meet normal operational expenses. The discounted water program is a concern because when Metropolitan sells water at a discount, it displaces full-rate water sales, which in turn leads to lower revenues overall and insufficient recovery of fixed costs..

While the staff continues to bring back recommendations based on the wishes of the member agencies, it has failed again to address the needs of Metropolitan. We understand why the member agencies would like Metropolitan to sell them water at a discount, what we do not understand is how the Metropolitan staff proposes to ensure benefit to all member agencies when discounted water is sold to some, or, how Metropolitan will be in a position to reverse its declining financial condition through the sale of discounted water.

The analysis provided in Board Memo 8-8 fails to address the very concerns raised by staff in its April 26, 2011 Board Memo (5-1) that first recommended reinstituting the sale of discounted water. Those concerns included – and remain:

- Questionable and unquantifiable performance criteria for a discounted water program;
- Loss of full service sales due to availability of discounted water;
- Unequal distribution of costs and benefits among member agencies; and
- Cash flow and budget issues associated with availability of discounted water.

The staff has also failed to respond to questions about Metropolitan's existing storage programs or the assumptions it is making about the use of that storage in the future. As a result, there is no basis for determining either the need for, or benefit of another new program.

We are attaching our past communications to the board on this subject. We request that staff respond, in writing, to the questions asked in our letters. Doing so would provide the board with a sound foundation to discuss the real policy principles involved in the proposed sale of discounted water. We would appreciate a written response to our letters in any event because they raise issues and concerns of great interest to our member agencies and water ratepayers.

Sincerely,

Lynne Heidel	Keith Lewinger	Fern Steiner
Director	Director	Director

cc: MWD Board of Directors
Jeff Kightlinger, General Manager
San Diego County Water Authority Board of Directors

Attachments:

1. April 25, 2011 letter to Jack Foley re: Board Memo 5-1 – Sale of Discounted Water and Attachment 1: Issues Associated with the Sale of Discounted Water by MWD
2. May 6, 2011 letter to Jeff Kightlinger re: Board Memo 5-1 – Sale of Discounted Water
3. September 12, 2011 Comments and Questions on Board Memo 9-2 – Update on Replenishment Service Program, Director Keith Lewinger
4. October 7, 2011 letter to Jack Foley re: Water Planning and Stewardship Committee Items 6a, 6b, and 6d

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October 25, 2011

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

MEMBER AGENCIES

Carlsbad Municipal Water District
City of Del Mar
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Helix Water District
Lakeside Water District
Olivenhain Municipal Water District
Otay Water District
Padre Dam Municipal Water District
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Santa Fe Irrigation District
South Bay Irrigation District
Vallecitos Water District
Valley Center Municipal Water District
Vista Irrigation District
Yuima Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

Re: KPMG Audit Report of MWD's Basic Statements for Years ended June 30, 2011 and 2010

Dear Chairman Foley:

The Auditor's report states that it is prepared in accordance with Government Auditing Standards. Though these standards do not require the presentation of budgetary information for Enterprise funds, it would be extremely helpful for this information to be presented as supplemental information in the Comprehensive Annual Financial Report (CAFR) following the notes to the financial statements, so it could provide a context for evaluating evidence and understanding of findings, conclusions and recommendations in the report.

Referring to page 13, the information on future debt service is misleading as it does not include projected future debt issuance. It should be noted that it does not include projected future debt issuance.

In the CAFR transmittal letter it would be prudent to disclose the potential impacts of Proposition 26 on revenue policies, in particular, that the collection of revenues under the current policy for conservation and Local Resource Programs may not meet Proposition 26 or other legal requirements.

Referring to page 58, Bay Delta discussion mentions it is expected that the BDCP will be approved, and a permit decision will be made in 2012, but the report should disclose the potential cost impacts to MWD of the BDCP plan.

Referring to page 60, SDCWA litigation disclosure mentions that the Exchange Agreement requires MWD pays the disputed portion paid by SDCWA if the Water Authority prevails, but it should also disclose that in accordance with the Exchange Agreement MWD is required to escrow the disputed funds each year until the litigation is completed.

Referring to page 69, the discussion should disclose that there is an escrow account for the SDCWA litigation, identify where it is held and that as well as any implications for reserve fund Board policy minimums.

We request that management respond in writing to the issues identified in this letter.

Sincerely,

Jim Bowersox
Director

Lynne Heidel
Director

Keith Lewinger
Director

Fern Steiner
Director

cc: MWD Board of Directors

San Diego County Water Authority
4677 Overland Avenue • San Diego, California 92123-1233
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October 7, 2011

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

MEMBER AGENCIES

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OTHER REPRESENTATIVE

County of San Diego

Re: Water Planning and Stewardship Committee items 6a, 6b, and 6d

Dear Chairman Foley,

We have reviewed the staff reports to be discussed under Committee items 6a, 6b and 6d at the October 11, 2011 Water Planning and Stewardship Committee. The reports provide a long list of activities described as implementation of the 2010 Integrated Resources Plan (IRP) including BDCP and other imported water projects, recycled water projects, conservation, seawater desalination and, the sale of discounted water. What is absent from the reports is any analysis showing:

- The demand for all of the water that will be produced by these projects;
- The rate increases associated with implementation of all of these projects;
- The regional benefit (to all member agencies paying the rates) of payments by Metropolitan for some member agency local water supply projects;
- The regional benefit (to all member agencies paying the rates) of the sale of discounted water by Metropolitan at a time when its water sales are more than 25 percent lower than projected and water rates are far higher than projected in Metropolitan's adopted Long Range Finance Plan; or
- How all of these projects are expected to be paid for.

Almost twenty years ago, the Metropolitan Blue Ribbon Committee Task Force urged Metropolitan to fully integrate its resource planning and rate structure efforts because, "reliability, cost and demand are all interdependent and should be treated that way in the IRP and rate structure reform processes" (page 9). Unfortunately, Metropolitan has steadfastly refused to do so – as reflected in this month's board reports of ongoing project implementation without any discussion whatsoever about cost or demand. Metropolitan's stubborn refusal to reduce its spending and operations is inconsistent with the economic reality today facing every city and water retailer in Southern California.

The IRP states that it is based on "adaptive management." It is time now for Metropolitan to "adapt" to actual, changed circumstances including dramatically reduced sales, dramatically

reduced projected demand for Metropolitan water, and, rapidly escalating water rates that will further dampen demand for Metropolitan water.

Since 2003, Metropolitan's expenditures have exceeded its revenues for six out of nine years, and for the same number of years, it has diverted funds intended for pay-as-you-go capital projects to pay for operational expenses. Metropolitan's financial reserves are being depleted, and now stand at their lowest level in 20 years. Metropolitan must stop analyzing project implementation in a vacuum and on a piecemeal basis.

The rate increases associated with declining sales and new projects are inevitable. The impacts of these rate increases are already being felt throughout Southern California. We strongly urge Metropolitan to cease entering into any new project funding agreements and cease the sale of discounted water until Metropolitan staff and board update IRP demand projections to reflect current realities.

Metropolitan needs a rate structure and long-term financial plan that are fully integrated with realistic demand projections. Metropolitan must conduct a cost/benefit and cost of service analysis to justify both the investment of regional ratepayer dollars in member agency water supply projects and the sale of water at a discount. Not only is this required by law, but it is sound fiscal planning that is essential at a time when Metropolitan's revenues are clearly insufficient to pay for its current costs and programs.

Sincerely,

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

Cc: MWD Board of Directors
Jeff Kightlinger

San Diego County Water Authority
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(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

August 22, 2011

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

MEMBER AGENCIES

Carlsbad Municipal Water District
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OTHER REPRESENTATIVE

County of San Diego

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.

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). 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.

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 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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OTHER REPRESENTATIVE

County of San Diego

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

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May 6, 2011

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

MEMBER AGENCIES

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OTHER REPRESENTATIVE

County of San Diego

Board Memo 5-1 – Sale of Discounted Water

Dear Jeff,

Thank you for responding to our April 25, 2011 letter regarding MWD's proposed sale of discounted water to selected member agencies. We appreciate that water supply conditions in 2011 have improved significantly; however, the question before the board is what to do with the water that is now available to MWD.

You state in your letter that MWD will maximize the use of its storage assets in 2011 to store available supplies. Director Steiner has requested and you have agreed to provide detailed information how MWD will do that. *Past MWD board reports show that MWD has ample storage and put capacity available to store all of the available water in MWD storage facilities.* Indeed, by our calculation, even if all of the available water is stored by MWD – as we believe it should be – MWD's storage will remain less than half full.

You also state that MWD will likely end the year with its regional storage reserves at the "highest levels in history"; however, this observation fails to take into account the *fundamental shift in MWD's water supply reliability planning which – unlike past history – now relies heavily upon the withdrawal of water from storage in dry years.* That is why the Water Authority has supported MWD's multi-billion dollar investment in storage facilities and agreements, which provide more than 5 million acre feet of storage capacity. Given this water supply strategy and investment, it is difficult to understand why MWD now has no intention of maximizing its investment in storage in a year like this, when water is available. MWD is barely out of a multi-year allocation, yet instead of filling its storage reserves, it wants to sell it at a discount.

The problems with the replenishment program have been previously documented and we will not repeat them here. MWD has been well aware of these concerns for many years but has failed to address the problems in any revised board policy or otherwise. Suffice it to say that the program does not provide benefits to MWD commensurate with the cost to MWD of the program. If MWD is intent on selling discounted water, then it should be made available to all MWD member agencies equally, not just to select agencies on the purported basis of a clearly flawed water supply management program.

On the financial side, the board memo and your letter are clear that under the discounted sales

proposal, MWD will not recover its fixed costs. This month's staff report shows MWD's FY 2011 sales have further dropped to 1.6 million acre feet (MAF), from the budgeted 1.93 MAF. Although short term cash flow may be improved by the proposed sale of discounted water, it has a deleterious effect on MWD's financial position overall. We believe you know that MWD's fiscal crisis is real – we would welcome the opportunity to work with you on finding real solutions.

Regarding your comments on the member agencies' willingness to pay for current and future fixed costs, our comments were taken directly from the MWD board memo citing the member agencies' "budgetary and fiscal constraints" as the reason they are not buying MWD water now at the full price that was assumed in the current fiscal year budget. Clearly, the sale of water at full price would be the preferred option because the region would achieve the same storage and water supply benefits and MWD would come closer to hitting its own budget, which is more than $150 million short that also threatens to leave reserves precariously low.

Finally, we believe you know that the Water Authority's litigation has nothing to do with challenging State Water Project costs – the only question is how those costs should be allocated between supply and transportation. The Water Authority expects to remain one of MWD's largest customers and to pay its fair share of MWD's costs under its State Water Project supply contract. Indeed, to our knowledge, the Water Authority is the only MWD member agency that has actually offered to enter into a long-term contract with MWD for the purchase of State Water Project water and other supplies and services. With firm contracts, MWD could count on being able to cover its fixed costs, now and in the future. We would be happy to make a presentation to the board on the history of that offer as well as make a proposal for the future. We agree that MWD is in a fiscal crisis and the gimmicks being employed this year – including a "fire sale" of discounted water – will not solve or even address the real problem.

Sincerely,

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

cc: Jack Foley, MWD Board Chairman

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

MEMBER AGENCIES

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

OTHER REPRESENTATIVE

County of San Diego

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
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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

MEMBER AGENCIES

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

OTHER REPRESENTATIVE

County of San Diego

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