



San Diego County Water Authority

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

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

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
Public Utility District

Helix Water District

Lakeside Water District

Olivenhain
Municipal Water District

Otay Water District

Padre Dam
Municipal Water District

Camp Pendleton
Marine Corps Base

Rainbow
Municipal Water District

Ramona
Municipal Water District

Rincon del Diablo
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Vista Irrigation District

Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

Re: 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 reinstating the sale of discounted water. Those concerns included – and remain:

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- 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
Director

Keith Lewinger
Director

Fern Steiner
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



San Diego County Water Authority

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April 25, 2011

John V. (Jack) Foley, 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
 - 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
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 - San Dieguito Water District
 - Santa Fe Irrigation District
 - South Bay Irrigation District
 - Vallecitos Water District
 - Valley Center Municipal Water District
 - Vista Irrigation District
 - Yuima Municipal Water District
- OTHER REPRESENTATIVE**
- County of San Diego

Re: Board Memo 5-1 – Sale of discounted water

Dear Chairman Foley:

We have reviewed Board Memorandum 5-1 regarding the sale of discounted water by MWD and would like the following comments to be placed in the record by this letter and its attachment. The sale of discounted water by MWD at this time raises many questions and concerns, which we have organized and discuss in detail in Attachment 1 to this letter. We request that the staff respond in writing to these questions and concerns prior to the board taking any action.

Given the staff’s own analysis, which describes its concerns about the performance and equity of the existing Replenishment Service Program (replenishment program) – it acknowledges that there is an “imbalance” between MWD costs and benefits under the Program (page 4) – we are surprised that the staff recommendation is nonetheless to support the sale of discounted water under the replenishment program.

While the recommended action takes into account the budgetary and fiscal constraints the member agencies have, it does not analyze or meaningfully address the unprecedented budgetary and fiscal constraints plaguing MWD. Our board’s fiduciary duty is to MWD – not the member agencies. We fail to meet that duty if we vote to sell discounted water under a program that does not provide commensurate benefits to MWD. This is all the more important at a time when we are confronting a nearly \$200 million budget shortfall in the current fiscal year.

The board memo is clear on its face that the replenishment program does not provide a proper foundation for the sale of discounted water. The Water Authority does not support the sale of discounted water by MWD under these conditions. But if the board chooses to do so in order to generate sales in the current fiscal year, then it should be made available to all of MWD’s member agencies, rather than limited to replenishment sales.

Sincerely,

Jim Bowersox
Director

Lynne Heidel
Director

Keith Lewinger
Director

Fern Steiner
Director

Attachment 1: Issues Associated with the Sale of Discounted Water by MWD

cc: Jeff Kightlinger, General Manager

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**Board Memorandum 5-1 – April 26, 2011 Special Board Meeting
Issues Associated with the Sale of Discounted Water by MWD**

1. The real issue before the board is price – not local water storage.

The board memo talks about “optimizing the reliability of water supply into the service area,” but it is apparent that the real issue before the board is the price. MWD has already adopted a 2010/11 Water Management Program for local storage that allows member agencies to purchase additional water for local storage while protecting them from Water Supply Allocation Plan (WSAP) penalties. Some member agencies have purchased supplies under this program, but others have held out in hopes of receiving discounted replenishment water.

2. MWD should be fully utilizing its own dry-year storage portfolio, rather than selling water at a discount to its member agencies.

The board memo states that MWD is facing the “unexpected challenge” of managing and storing water in 2011. This is a very perplexing statement and calls into question MWD’s water supply management capabilities. Storing water in good years is at the very heart of the water supply reliability program MWD developed through its Integrated Resources Plan (IRP).

Nine years ago, when MWD lost 662,000 AF of surplus water on the Colorado River *annually*, it shifted to a water supply reliability strategy that depends heavily on storing water in wet years in order to meet water demands during subsequent dry years. When this strategy was initially employed, MWD was counting on having water supplies that were “surplus” to its needs and available for storage seven out of every 10 years. To implement this strategy, MWD established rates and collected revenues from its member agencies and paid billions of dollars to create the dry-year storage accounts that today are in excess of 5 MAF. The Water Supply and Drought Management (WSDM) plan attached to the board memo shows a 2011 storage put capacity of more than 1 MAF.

More recently, MWD staff has consistently stated that the constraints in the Delta now mean that MWD can count on wet-year supplies being available for storage in only three of every 10 years; this is one of those three years. But rather than filling its own storage accounts, MWD staff is recommending selling this water at a discount to its member agencies.

We also find it troubling that for the first time – and in the context of a recommendation to sell water at a discount – the board has been informed that “some of the storage programs and locations” are “less desirable choices” for storage management. Further, that there are “increased risks of future losses from those programs, potential cost implications, and concerns about future dry-year performance.” Given this description, it is difficult to understand why MWD made these “less desirable” dry-year storage investments in the first place. We request that a complete review of the dry-year storage program be placed on the agenda at the next board meeting and before the board takes action to sell the water that is available for storage at a discount.

A final note on MWD’s dry-year storage portfolio relates to the budget. It is not possible to manage a dry-year storage account without incurring costs associated with the put and take of water into and from storage. The fact that MWD failed to adequately budget these costs is

certainly no excuse to sell discounted water now in order to generate cash-flow. We request an analysis of how staff has budgeted these costs in the past and how it proposes to budget the costs associated with its dry-year storage program in the next and subsequent budget years. We also request a schedule of all costs and capital investments associated with developing new water supplies that will be needed to replace the water now proposed to be sold at a discount.

3. The sale of discounted water will displace full-service sales and exacerbate MWD's current budget and fiscal crisis.

The board letter is completely silent on the most damaging consequence of selling discounted water: every acre foot sold at the proposed discount will displace an acre-foot sale of water out of MWD's dry-year storage program at the full-service rate. The promise that this discounted water sales program will increase revenues to MWD focuses only on the revenues from discounted water sales and associated near-term fiscal consequences. Ignored in the board memo entirely is the indisputable truth that agencies that would have purchased water at the full service rate – either this fiscal year or in a subsequent year – will instead purchase that water at a discount through the direct discount of up to \$143 per acre-foot and by avoiding future full service rate increases. MWD will not “make money” by selling water at a discount, it will lose money – 200,000 acre-feet of discounted water sales results in the loss of potentially more than \$28 million in revenues. The impact of the lost revenues may not be fully realized in FY 2012, but will certainly be felt in the future.

It is apparent that the reason some MWD member agencies are holding back from purchasing water at the full service rate is precisely because they are waiting to buy it at a discount. That's a smart move for the member agency, but is certainly not in MWD's best interest.

The MWD board is legally required annually to adopt a cost of service and revenue requirement and fix rates that, taken together with other revenue sources, will be sufficient to pay MWD's fixed costs and other expenses. The MWD board has failed to do this and, instead, continues to rely upon inflated sales projections to support its water rates, budget and overspending. At its last meeting, the board was presented with information that projected MWD sales in the current fiscal year are trending to be 291,300 acre-feet below budget. At its meeting on the budget, MWD staff also assessed the value of its water in storage using full service rates. There is no way to reconcile the board's actions in adopting cost of service and revenue requirements with the proposed sale of discounted water.

4. The board memo does not provide a policy or legal basis for the sale of discounted water for replenishment.

The board memo presents a detailed list of concerns with the replenishment program (page 2), notably:

- Questionable and unquantifiable performance and expectations;
- Potential of shifting water sales within a year as opposed to generating true longer-term storage;
- Potential offset of full service sales;

- Unequal distribution of costs and benefits among participating and non-participating agencies;
- Questions on whether water was being stored for future use as opposed to being purchased to refill overdraft;
- Difficulties in measuring and verifying in-lieu deliveries to storage; and
- Cash-flow and budgeting issues associated with the frequency under which replenishment supplies are available.

Each of these seven concerns should be significant enough to dissuade the board from approving discounted replenishment sales. Taken together, however, the seven concerns represent perhaps the most troubled program in MWD's recent history. It is a confounding disconnect, therefore, that the board is being asked to forge ahead with the program without regard to these concerns. The board memo, as written, is very clear that there are significant questions about the performance and equity of the replenishment program. We request that the staff present a further analysis and respond to the "disconnect" between the information provided in the board memo and the staff recommendation for action.

5. The sale of discounted water sends the wrong message at a time when MWD is promising to pay substantial costs associated with a Delta Fix.

If MWD's member agencies are – as is clear from the board memo – unable or unwilling to pay for MWD's current fixed costs, how can MWD credibly commit to pay the additional costs associated with a Delta Fix? Will MWD's member agencies not be subject to the same "budgetary and fiscal constraints" when faced with the costs of a Delta Fix and other IRP investments? If this is indeed the economic reality – that current full service rates are too expensive to encourage MWD water sales to its member agencies – then the MWD board must reconsider MWD's entire water resources strategy. If we can't afford to pay our current fixed costs then it is difficult to see how we can afford to pay the billions of dollars of investment outlined in the 2010 IRP, including the Delta Fix being negotiated by management, seawater desalination projects and a host of other projects.

The continued disconnect between the board's decisions to spend money and the member agencies' willingness to pay for MWD projects is threatening MWD's very financial viability.



San Diego County Water Authority

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May 6, 2011

Jeff Kightlinger, General Manager
Metropolitan Water District of Southern California
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Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

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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

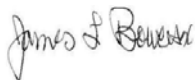
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proposal, MWD will not recover its fixed costs. This month's staff report shows MWD's FY 2011 sales have further dropped to 1.6 million acre feet (MAF), from the budgeted 1.93 MAF. Although short term cash flow may be improved by the proposed sale 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.

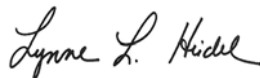
Regarding your comments on the member agencies' willingness to pay for current and future fixed costs, our comments were taken directly from the MWD board memo citing the member agencies' "budgetary and fiscal constraints" as the reason they are not buying MWD water now at the full price that was assumed 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
Director



Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director

cc: Jack Foley, MWD Board Chairman

September 12, 2011

To: MWD Water Planning & Stewardship Committee

From: Director Keith Lewinger, San Diego County Water Authority

Re: Comments and Questions on Board Memo 9-2 – Update on Replenishment Service Program

1. The Board Memo states that the only policy for this program is MWD Administrative Code Section 4514. Is there any other board policy that the staff considers relevant or controlling for purposes of the meetings it is having with the member agencies and groundwater basin managers?

2. Are the “Key Development Principles” referenced in 9-2 intended to be a statement of board policy or what the member agencies want? It appears that the concerns of member agencies and groundwater basin managers are being captured but not so much the program needs from MWD’s point of view.

3. Staff’s April 26, 2011 Board Memo 5-1 described many of the concerns about the performance and equity of the existing Replenishment Service Program, but they are not discussed in Board memo 9-2. The concerns as described by staff last April included:

- Questionable and unquantifiable performance expectations generally for the Replenishment Service Program.
- Potential of shifting water sales within a year as opposed to generating true longer-term storage.
- The potential offset to full service sales.
- Unequal distribution of costs and benefits among participating and non-participating agencies.
- Questions whether the water was being stored for future use as opposed to being purchased to refill overdraft.
- Difficulties in measuring and verifying in-lieu deliveries to storage.
- Cash flow and budgeting issues associated with the frequency under which replenishment supplies are available.

4. The Water Authority thought these questions should have been addressed – and MWD’s own regional storage fully replenished – prior to resuming the sale of discounted water in April. It is certainly the time to do so now, as the Replenishment Service Program is being reviewed. ***And, the board needs to be involved in the process now, prior to proposals being developed, in order to establish a policy framework.***

5. While the “Key Development Principles” may have been sufficient to initiate discussions with the member agencies and groundwater basin managers, there are key policy issues that must be addressed as part of the Board’s consideration of any new Replenishment Service Program proposal. As such, in addition to those policy questions raised in MWD’s April 26, 2011 Board memo, as a board member it is my request that the following issues also be addressed for the planning periods 2015, 2020 and 2035, in order to kick off a substantive board discussion on policy issues:

- No one questions the wisdom of local water storage and conjunctive use. However, a new Replenishment Service Program proposal must address the program’s costs and the benefits including:

- How does the MWD region benefit? Please address both water supply and budget impacts. One of the fundamental questions that needs to be addressed is, under what circumstances if any, can MWD afford to sell water at a discount?
- What MWD costs if any will be avoided through the implementation of a new Replenishment Service Program?
- What assumptions are used about MWD's own storage programs and the role MWD storage will play in meeting water supply needs in dry years?
 - How much storage does MWD plan to maintain?
 - What is the total cost of MWD's storage programs, including the cost of putting water into storage during the years it is available?
 - Does staff intend to budget that cost in the future?
- What are the assumptions about how often and at what quantity water will be available for put into storage? Conversely, how often and at what quantity are you assuming water from storage will needed to meet demand?
- Last April, the board was informed that some of MWD's storage programs and locations were "less desirable" choices for storage management and that there were "increased risks of future losses from those programs, potential cost implications and concerns about future dry year performance." Has staff completed its review of these concerns and what recommendations is it making to the board now as a result?
- How will the implementation of a new Replenishment Service Program affect MWD's future water rates and demand? What policies can ensure that the new Replenishment Service Program would not displace full service purchases?
- Would it be more equitable to simply distribute discounted water to all member agencies when it is deemed available under specified conditions?

I hope that these and the questions and concerns of all board members about the development of a new Replenishment Service Program will be addressed at board meetings over the next several months as the member agency technical review continues. I would also suggest that a revised schedule be developed and presented at the next committee meeting that recognizes the need for Board review and policy input prior to any specific proposals being developed by staff and the member agencies and groundwater basin managers. I don't believe this can be accomplished within the December timeframe proposed by staff, but should be discussed by the Committee at an upcoming meeting. .



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October 7, 2011

John V. Foley, Chairman
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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

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Mr. Foley
October 7, 2011
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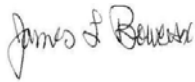
reduced projected demand for Metropolitan water, and, rapidly escalating water rates that will further dampen demand for Metropolitan water.

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.

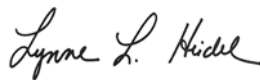
The rate increases associated with declining sales and new projects are inevitable. The impacts of these rate increases are already being felt throughout Southern California. We strongly urge Metropolitan to cease entering into any new project funding agreements and cease the sale of discounted water 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
Director



Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director

Cc: MWD Board of Directors
Jeff Kightlinger