



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Counsel

May 23, 2017

Mark Hattam, Esq.
General Counsel
San Diego County Water Authority
4677 Overland Avenue
San Diego, CA 92123-1233

Re: Your Letter Dated May 9, 2017

Dear Mr. Hattam:

This letter responds to your May 9, 2017 letter on behalf of the San Diego County Water Authority (SDCWA) objecting to the Water Supply Agreement (Agreement) between Metropolitan and the Los Angeles Department of Water and Power (LADWP), and expressing the intent of the SDCWA to “recover the share of costs it is being forced to subsidize under the Agreement.”

On March 20, 2017, the Mayor of Los Angeles issued an emergency proclamation based on the massive amounts of snow and rain in the Eastern Sierra which threaten the safety of public property, infrastructure, and the environment. This emergency will impact LADWP’s aqueduct, water gathering and delivery facilities, and quality control facilities, in Mono, Inyo, Kern, and Los Angeles Counties. In order to avoid potential adverse impacts to its facilities and the environment, LADWP requested that, on an emergency basis, Metropolitan take excess supplies from the Los Angeles Aqueduct.

On April 10, 2017, Metropolitan and LADWP entered into the Agreement. The Agreement provides that Metropolitan may, at its sole discretion, determine whether and how much LADWP water to accept and whether to take any water that it chooses to accept at Metropolitan’s Jensen Treatment Plant or the East Branch of the California Aqueduct.

Your letter characterizes the Agreement as concurrently a water service, an exchange, and a wheeling agreement. As you are aware, those are three very different things and no agreement, transaction, or activity could be all three at the same time.

The Agreement provides that Metropolitan will keep either one-third or one-half of the water it accepts from LADWP. The water kept by Metropolitan will be sold back to LADWP at Metropolitan’s full service rate, or, if LADWP does not purchase the water, Metropolitan may sell it to other member agencies or retain it in Metropolitan’s storage. In addition, Metropolitan

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is not required to return to LADWP any water that would displace water otherwise available to Metropolitan.

As further explained below, your claims that the Agreement violates the Metropolitan Water District Act and Administrative Code are unfounded.

SDCWA Claim 1

You claim that the Agreement violates section 134 of the MWD Act because LADWP is not charged Metropolitan's rates for wheeling service and capacity charge under sections 4405 and 4403 of Metropolitan's Administrative Code.

Metropolitan Response to Claim 1

The Agreement does not violate section 134 of the MWD Act because Metropolitan is not providing either water service or wheeling and sections 4405 and 4403 of Metropolitan's Administrative Code are not applicable.

The Agreement does not provide for wheeling

Section 4405 of Metropolitan's Administrative Code applies to "Wheeling Service," which is defined in section 4119. Section 4119 of Metropolitan's Administrative Code defines "Wheeling Service" as "the use of Metropolitan's facilities, including its rights to use State Water Project facilities, to *transport water not owned or controlled by Metropolitan to its member public agencies*, in transactions entered into by Metropolitan *for a period of up to one year.*" (Italics added.) Thus, if Metropolitan's facilities are not being used to transport third-party water, or if the transfer is not being made to a member agency, or if the transaction is not limited to one year, section 4405 does not apply.

Here, LADWP is not using Metropolitan's facilities to move LADWP's water, or to move any third-party water to LADWP. Rather, the Agreement allows Metropolitan to accept water from LADWP to help relieve an extraordinary declared emergency and then months or years later return either a lesser amount of water or no water to LADWP. (Agreement, sections 1 and 2.) Additionally, the term of the Agreement is for more than one year. Metropolitan may receive water from LADWP through March 31, 2018. If Metropolitan returns any water to LADWP, it can occur through December 31, 2019. (Agreement, sections 1 and 2.) The Agreement is not a wheeling agreement subject to section 4405.

Capacity Charge under Section 4403

The Capacity Charge under section 4403 of Metropolitan's Administrative Code does not apply to the Agreement. The purpose of the Capacity Charge is to "provide a price signal to encourage

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member agencies to reduce peak day demands on Metropolitan's system and to shift demands that occur during the May 1 through September 30 period into the October 1 through April 30 period." (Metropolitan's Rate Structure Administrative Procedures Handbook, FY 2016/17, p. 11.) The Agreement allows Metropolitan to return water "only at times when Metropolitan determines, in its sole discretion, that it has sufficient capacity to return the water through a Metropolitan service connection with LADWP or at another mutually agreed upon location." (Agreement, section 2(d).) Because Metropolitan, rather than LADWP, determines when to return water, charging LADWP the Capacity Charge would not serve the purpose of the charge, which is to encourage member agencies to take less or no water during May 1 through September 30. Thus, section 4403 does not apply to the Agreement.

SDCWA Claim 2

You claim that the General Manager lacks authority to execute the Agreement under section 4207(c) of Metropolitan's Administrative Code because: (1) there has been no determination that the Agreement provides water quality benefits; (2) the annual total of all exchanges under section 4207(c) exceeds 50,000 acre-feet; and (3) the annual cumulative net exchange costs of exchanges under section 4207(c) exceed \$500,000.

Metropolitan Response to Claim 2

Sections 6140, 8121(b), and 4209 of the Administrative Code authorize the General Manager to execute the Agreement. Section 6140 of the Administrative Code grants the General Manager broad authority to "exercise all executive, administrative, and ministerial powers not specifically reserved to the Board, General Counsel or General Auditor by law, this Code or by order of the Board, or by law to any other officer." No other provision specifically reserves the authority to enter into the Agreement with LADWP and thus the General Manager has such authority under section 6140.

Section 8121(b) of the Administrative Code authorizes the General Manager to execute contracts "if the amount payable or expected to be paid by the District under the terms of a contract is \$250,000 or less." Under the terms of the Agreement, there is no amount payable or expected to be paid by Metropolitan and thus the General Manager has authority under section 8121(b).

Section 4209 provides that the "District may join or enter into agreements with member agencies to make more effective use of water resources, including agreements providing for the wheeling, exchange, or banking of water, so long as such agreements serve a purpose of the District." The Agreement is with a member agency, and it helps prevent the loss of water to the region and provides water to Metropolitan at no cost. The General Manager has exercised his contracting authority consistent with section 4209.

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Contrary to your claim, section 4207(c) does not prohibit the General Manager from executing the Agreement. Rather, it provides additional authority to the General Manager to execute exchange agreements that exceed the General Manager's standard contracting authority of \$250,000 under section 8121(b). The authority for water exchanges under section 4207(c) is specific to meet water quality benefits and for that reason the section grants additional contracting authority up to cumulative annual amounts of \$500,000 and 50,000 acre-feet. The authority granted therein does not eliminate the contracting authority under sections 6140, 8121(b), and 4209. Therefore, because the Agreement does not exceed the General Manager's standard contracting authority of \$250,000, and the General Manager does not require additional authority beyond that amount for water quality benefits, section 4207(c) does not apply.

SDCWA Claim 3

You claim that the Agreement violates section 4405 of Metropolitan's Administrative Code because Metropolitan's System Access Rate and Water Stewardship Rate apply to wheeled water.

Metropolitan Response to Claim 3

As noted above, the Agreement is not a wheeling agreement.

SDCWA Claim 4

You claim that the Agreement violates section 4403(a) of Metropolitan's Administrative Code and Metropolitan's Rate Structure Administrative Procedures Handbook because wheeled water must be included in the measurement of peak day flow for purposes of billing the Capacity Charge to member agencies.

Metropolitan Response to Claim 4

As noted above, the Agreement is not a wheeling agreement.

SDCWA Claim 5

You claim that the Agreement should charge LADWP an appropriate share of the costs for LADWP's use of Metropolitan's Water Surplus and Drought Management (WSDM) storage facilities.

Metropolitan Response to Claim 5

As SDCWA points out, Metropolitan's storage programs are allocated to Metropolitan's supply rates. (SDCWA Letter, p. 5.) Through the Agreement, Metropolitan will be receiving a water

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supply to either sell back to LADWP at Metropolitan's full service rate, to sell to other member agencies at Metropolitan's full service rate, or to store. SDCWA argues that LADWP should instead pay a pro rata share of storage costs, unquantified by SDCWA itself. SDCWA provides no basis for this.

As you know, California has experienced nearly six years of extreme drought, immediately followed by historically wet conditions in many parts of the state. The management of resources to ensure long-term water supply reliability for all of its member agencies requires a flexible response to address hydrologic conditions as they occur. The Agreement does that in a manner that provides significant water supply benefits to Metropolitan and all 26 member agencies in a manner that is fully compliant with the MWD Act and Administrative Code.

LADWP is not storing water with Metropolitan under the Agreement. Nor does LADWP have a right to space in a Metropolitan WSDM storage facility. The Agreement allows Metropolitan total flexibility in the management of the water it accepts from LADWP. For example, if Metropolitan accepts LADWP water at the Jensen Treatment Plant in 2017, that supply will be immediately treated and delivered to Metropolitan member agencies as a full service water sale.

While the net effect of accepting water from LADWP may result in an increase to Metropolitan's own storage supplies, that result increases future regional reliability. Such water benefits all Metropolitan member agencies. To the extent any LADWP water could displace Metropolitan's own storage supplies, the Agreement allows Metropolitan the sole discretion to decline to accept water. Further, Metropolitan is protected from losses that may result from the acceptance of water by a one-for-one reduction in the obligation to deliver water to LADWP, should Metropolitan lose water that would otherwise be available. (Agreement, section 2(e).) The Agreement does not provide LADWP a guaranteed right to Metropolitan's storage facilities for which Metropolitan should separately charge.

SDCWA Claim 6

You claim that the Agreement provides no value to Metropolitan and that it may be detrimental to Metropolitan and its other member agencies.

Metropolitan Response to Claim 6

The Agreement provides substantial benefits to Metropolitan. To the extent implemented, the Agreement provides value to Metropolitan by increasing Metropolitan's water supply which is then available to all of its member agencies in current or future years. Metropolitan receives the benefit without detriment to Metropolitan or its member agencies.

Metropolitan's capacity to enter into an Agreement that is beneficial to both LADWP by averting potentially significant adverse impacts to public infrastructure and the environment, if excess

surface water supplies go unmanaged, and to Metropolitan by preventing a waste of water and increasing Metropolitan's supplies, exemplifies the benefits and flexibility of Metropolitan's integrated distribution and storage infrastructure.

Metropolitan's staff evaluated the proposed Agreement and determined that Metropolitan could help LADWP during the emergency in a manner that also provides a benefit to Metropolitan by improving water supply reliability and reducing pumping costs.

Staff performed a basic cost/benefit analysis that showed the value of the avoided energy costs and the increased supply exceed any potential costs.

Metropolitan Cost/Benefit Analysis

Case 1 – No Spill Assumptions:

1. No spill of 50,000 acre-feet of water LADWP provides to Metropolitan.
2. Water returned to LADWP will be after 2017. Thus, LADWP will deliver 50,000 acre-feet to Metropolitan and LADWP will purchase 25,000 acre-feet at the full service water rate. An important element to understand is that LADWP is providing both the energy and water supply for the water Metropolitan sells at the full service rate.
3. 50% of LADWP supplies will be provided to Jensen Treatment Plant and 50% will be introduced to East Branch of the California Aqueduct.

Benefits

Metropolitan benefits from the program in at least four ways. First, Metropolitan avoids SWP energy costs in moving supplies along the East Branch of the California Aqueduct. Second, after water is delivered to the East Branch of the California Aqueduct, Metropolitan will receive a net credit from water introduced before the Pearblossom Pumping Plant because there is power generation at the downstream Mojave and Devil Canyon Power Plants. Third, for the 50,000 acre-feet of LADWP water that is managed by Metropolitan, 25,000 acre-feet is returned to LADWP and 25,000 acre-feet is sold to LADWP at full service rates. Fourth, Metropolitan receives a water supply benefit by retaining 50,000 acre-feet of its own water to sell or store on behalf of the entire region, thus increasing regional water supply overall.

Avoided SWP Energy Costs on the East Branch	\$177/acre-foot ⁽¹⁾
Hydro Power Generation on the East Branch	\$18/acre-foot ⁽²⁾
<u>Revenue from LADWP at 2018 Tier 1 Supply Rate</u>	<u>\$209/acre-foot ⁽³⁾</u>
Total	\$404/acre-foot

Financial Benefit: \$404/acre-foot x 25,000 acre-feet = \$10,100,000

Case 2 – 100% Spill Assumptions:

1. LADWP provides Metropolitan 50,000 acre-feet of water; however, the water causes Metropolitan to lose water that would have been otherwise available to Metropolitan. Effectively, the LADWP supplies spill.
2. No water returned to LADWP at any time. No increase in water supply benefit to Metropolitan.
3. 50% of LADWP supplies will be provided to Jensen Treatment Plant and 50% will be introduced to East Branch of the California Aqueduct.

Benefits

Metropolitan financially benefits from the program in at least two ways. First, Metropolitan avoids SWP energy costs in moving supplies along the East Branch of the California Aqueduct. Second, after water is delivered to the East Branch of the California Aqueduct, Metropolitan will receive a net credit from water introduced before the Pearblossom Pumping Plant because there is power generation at the downstream Mojave and Devil Canyon Power Plants. These energy benefits apply to all the water LADWP provides to Metropolitan because they would have displaced an equivalent amount of water that would have otherwise required pumping along the East Branch of the California Aqueduct.

Avoided SWP Energy Costs on the East Branch \$177/acre-foot ⁽¹⁾

Hydro Power Generation on the East Branch
(50% of \$18/acre-foot) \$9/acre-foot ⁽⁴⁾

Total \$186/acre-foot

Financial Benefit: \$186/acre-foot x 50,000 acre-feet = \$9,300,000

Conclusion

There is no financial downside for Metropolitan resulting from the agreement with LADWP; only upside. Should LADWP supplies displace a Metropolitan supply that might have been received from the SWP, Metropolitan effectively avoids the SWP energy costs on the East Branch of the California Aqueduct with no cost or obligation to return water in the future. As a result of the increase of the SWP Allocation to 85%, LADWP supplies are at risk, yet benefits to Metropolitan are not eliminated because even if LADWP supplies are not returned, Metropolitan has avoided the energy costs to obtain those supplies from the SWP.

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Contrary to your assertions, there is no basis for your conclusion that the General Manager acted in an arbitrary and capricious manner by authorizing the Agreement. Nor is there a legal basis to terminate or cancel the Agreement. Metropolitan incurs no unrecovered costs and there is no subsidy to LADWP provided by SDCWA or any other member agency.

Very truly yours,



Marcia Scully
General Counsel

Attachment

cc: SDCWA Board of Directors
Metropolitan Water District Board of Directors
Member Agency Managers

Footnotes:

- (1) Energy costs from Reach 1 to Reach 18a (Banks to Pearblossom), \$176.58/acre-foot, 2017 Transportation Variable Plant Unit Rates, DWR, State Water Project Analysis Office, February 14, 2017
- (2) Energy credit from Reach 18a to Reach 26a (Pearblossom to Devil Canyon), \$18.04/acre-foot, 2017 Transportation Variable Plant Unit Rates, DWR, State Water Project Analysis Office, February 14, 2017
- (3) LADWP is providing additional water to the region above Metropolitan's base supplies. For every acre-foot managed for LADWP, LADWP provides one acre-foot of supply to Metropolitan that would be sold at the full service rate. The full service rate includes a water supply rate. The value of the water was assumed at the Tier 1 supply rate in 2018 at \$209/acre-foot. The actual water rate would be dependent on when the full service water sale occurs.
- (4) Of the 50,000 acre-feet delivered only 50% (25,000 acre-feet) of the supply is assumed delivered to the East Branch, so the credit is adjusted accordingly.