



THE CITY OF SAN DIEGO

MEMORANDUM

DATE: March 5, 2012

TO: Natural Resources and Culture Committee – Agenda of March 21, 2012

FROM: Roger Bailey, Director of Public Utilities

SUBJECT: Significant Issue Briefing – MWD Rate Increase Proposal

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**Background**

The Public Utilities Department purchases up to 90% of its water supplies from the San Diego County Water Authority (Water Authority) which, in turn, purchases a majority of its water supplies from the Metropolitan Water District of Southern California (MWD). Every two years, MWD staff proposes a biennial budget, revenue requirements, and water rates and charges for the upcoming two fiscal years to their Board of Directors for consideration. The MWD Board typically establishes the biennial budget and rates in April, which allows its member agencies to build this cost into their individual budgets and rates.

In San Diego's case, the Water Authority (which is the MWD member agency) would subsequently incorporate MWD's approved rates to establish its own biennial budget and rates recommendation, which is presented to the Water Authority's Board of Directors for consideration in June of the same year.

Once the Water Authority establishes its budget and rates, the City's Public Utilities Department incorporates these costs into the budget and rate proposals that are presented to Council for consideration. Given that the cost of imported water represents approximately half of the Public Utilities Department's annual budget, it is important to fully understand the justification of any proposed imported water rate increases and to advocate for all cost-savings opportunities.

**MWD and Water Authority Governance Background**

Both MWD and the Water Authority are governed by their member agencies. This is an important nuance in the decision-making authority of both the Water Authority's and MWD's Boards of Directors. According to the system established by the Water Authority, the City of San Diego currently has ten delegates serving on the 35-member Board of Directors. The ten delegates are appointed by the Mayor and confirmed by City Council and each serve 6-year terms. One seat is reserved for the Public Utilities Department Director. The rest of the seats are filled

by citizen volunteers. These delegates, known as the "City-10," caucus monthly in advance of each Water Authority Board meeting and receive analytical input from Public Utilities Department staff on both Water Authority and MWD-related issues.

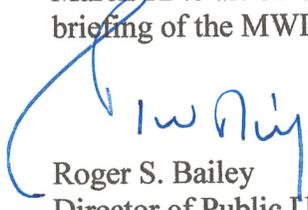
Two of the City's delegates are also named to represent the Water Authority on the MWD's Board of Directors. Together with two other Water Authority Board members, the Water Authority is represented on MWD's 37-member Board of Directors by four delegates. The MWD Directors caucus monthly in advance of the MWD Board meetings to receive analytical input from Water Authority staff.

### **Public Hearing Process**

Both MWD and the Water Authority hold Public Hearings in advance of the final Board vote on proposed budgets and rates. MWD's public hearing is currently scheduled for Monday, March 12 at its headquarters in Los Angeles. The Board is expected to vote on the proposed budget and rates the next day, March 13. The Water Authority's four delegates on the MWD Board have been actively involved in the budget discussions to date. Attached please find a copy of a letter outlining the delegates' concerns with MWD's proposed budget and rates (Attachment 1).

While MWD rate increases are always of concern, the Water Authority is noting particular disagreement with the nature of the proposed FY 2012-13 and FY 2013-14 rate increases as they appear to disproportionately load supply costs onto MWD rate categories associated with wheeling rates (the cost to use MWD facilities to transport Water Authority water supplies). The Water Authority is unique among MWD member agencies in paying MWD to "wheel" its proprietary water supplies from the Colorado River via MWD's facilities. As such, this cost-loading on the wheeling rates overcharges the Water Authority. While MWD does not benefit from this alleged shifting of costs, the other MWD member agencies would. Please see the attached Water Authority Fact Sheet on the MWD rate lawsuit (Attachment 2).

Public Utilities staff intends to join Water Authority staff during MWD's public hearing on March 12 to articulate concerns with the proposed MWD rates. Staff will present a thorough briefing of the MWD rate issues at the March 21 NR&C Committee meeting.



Roger S. Bailey  
Director of Public Utilities

ccp

Attachments: 1. Water Authority Delegates Letter to MWD dated February 3, 2012  
2. Water Authority Fact Sheet on MWD Rates Lawsuit



# 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
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fallbrook Public Utility District
- Helix Water District
- Lakeside Water District
- Olivewood Municipal Water District
- Olney Water District
- Padre Dam Municipal Water District
- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Romana Municipal Water District
- Rincon del Diablo Municipal Water District
- San Diego Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Volcanos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuma Municipal Water District

**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**  
**Director**

**Keith Lewinger**  
**Director**

**Fern Steiner**  
**Director**

**Doug Wilson**  
**Director**

**Attachment**

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

**OTHER REPRESENTATIVE**

County of San Diego

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

*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

**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**

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
<b>Total supply to MWD service area</b>	<b>1,867, TAF</b>	<b>1,922 TAF</b>
<b>Total MWD demand**</b>	<b>1,700 TAF</b>	<b>1,700 TAF</b>
<b>Excess supply</b>	<b>167 TAF</b>	<b>222 TAF</b>

\*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?

*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*

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.

*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*

**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.



# Water Authority Fighting for Lawful Water Rates at MWD

Illegal Water Rates Cost San Diego County Ratepayers Billions



## DIVERSIFICATION

Enhancing Water Supply Reliability

The San Diego County Water Authority is suing the Metropolitan Water District of Southern California to stop illegal water rate overcharges and its retaliatory business practices that illegally target and discriminate against the Water Authority and its ratepayers.

These practices, if not stopped, will continue to cost local water ratepayers tens of millions of dollars annually. In 2012, the overcharges are expected to be \$40 million. By 2047, the overcharges could exceed \$2.1 billion.

The Water Authority's lawsuit currently includes six causes of action against MWD. Three claims relate to how MWD's rate structure illegally overcharges San Diego County ratepayers tens of millions of dollars annually for the transportation of water.

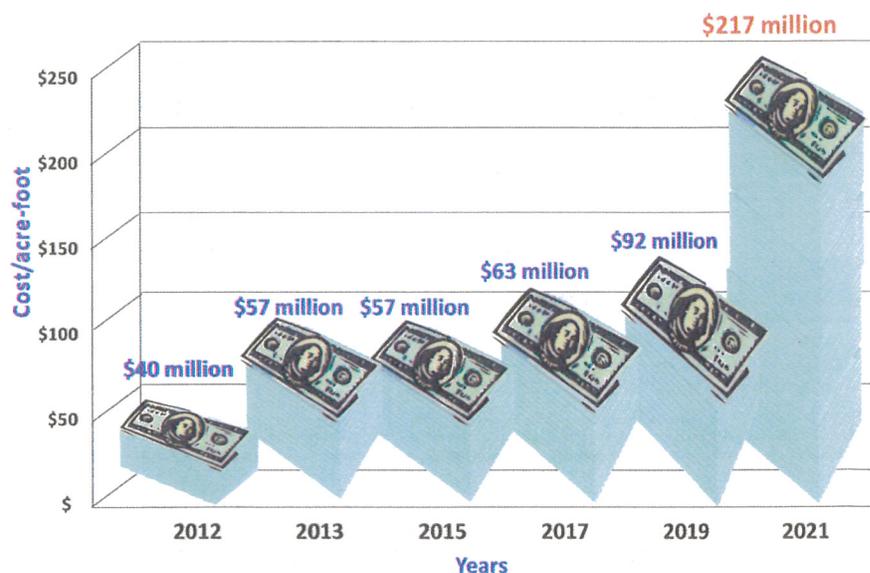
The Water Authority is the only MWD member agency that has secured its own Colorado River supplies and pays fees to use MWD's pipes to transport that supply. MWD has systematically overcharged the Water Authority for transporting these supplies.

Another claim relates to the violation of a 2003 contract with the Water Authority, where MWD agreed to charge lawful rates for transporting water. The lawsuit also asks the judge to overturn a punitive contract provision that punishes the Water Authority for challenging MWD's rates in court.

Finally, the suit asks the court to require MWD to properly calculate the Water Authority's Preferential Right to purchase MWD water. MWD has failed to include payments the Water Authority makes to the agency for transportation in the calculation of the Water Authority's Preferential Right, in violation of state law.

Impact of MWD Overcharges to Water Authority Ratepayers\*

*MWD's illegal rate structure charges a disproportionately high rate to transport the Water Authority's independent Colorado River supplies. As the Water Authority's Colorado River water supplies reach the maximum annual amount in 2021, those overcharges will grow to as much as \$217 million annually.*



\*Based on \$40 billion cost to fix the Bay-Delta.

## Water Authority Fighting for Lawful Water Rates at MWD

The case has been assigned to San Francisco Superior Court Judge Richard A. Kramer. The Water Authority expects a Superior Court decision by the end of 2012.

The Imperial Irrigation District and the Utility Consumers' Action Network have joined the lawsuit as interested parties on the Water Authority's side. Eight MWD member agencies joined in the suit on MWD's side.

### Why are MWD's Rates Illegal?

MWD is required by law to charge rates that reflect the actual, reasonable and proportionate costs of serving each class of its customers. The Water Authority's lawsuit claims MWD is improperly charging hundreds of millions of dollars annually in water supply costs to its System Access Rate, System Power Rate and Water Stewardship Rate. These three rate components comprise MWD's transportation charge.

**System Access Rate** is paid by MWD member agencies that buy MWD water or use MWD's facilities to transport water not purchased from MWD. More than 80 percent of MWD's State Water Project water supply costs – amounting to hundreds of millions of dollars annually – is assigned to this water transportation rate category, in violation of California law. These costs belong in the Water Supply Rate category.

**System Power Rate** recovers the costs of energy needed to pump water to Southern California. It is a charge applied to every acre-foot of water transported by MWD. The rate currently includes Department of Water Resources' energy costs for the State Water Project, which MWD does not own or operate. The costs of power needed by the state to deliver water supply to MWD's connections in Southern California are a supplier cost and part of the cost of that water supply. However, MWD improperly assigns that cost to its own transportation rate category. These costs belong in the Water Supply Rate.

**Water Stewardship Rate** recovers the cost of providing financial subsidies to MWD's member agencies for developing new local water supply projects. These subsidies are used for conservation, recycled water, desalination, or other new water supplies. However, MWD charges these water supply costs as a water transportation service. Because this rate pays for water supply development, it should be applied to the Water Supply Rate.

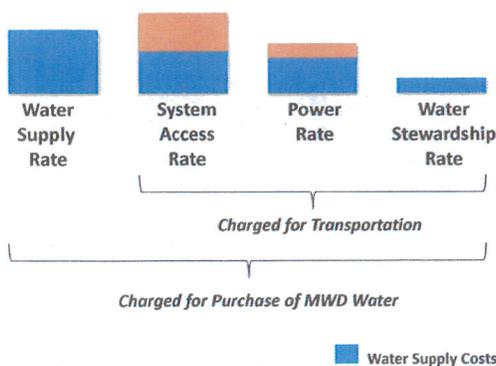
**Water Supply Rate** is supposed to recover the costs MWD incurs to acquire water supplies. This should include supplies it imports from the Colorado River, State Water Project and money it spends to support the development of new local water supplies and water conservation. All of these water supply costs belong in the Water Supply Rate category.



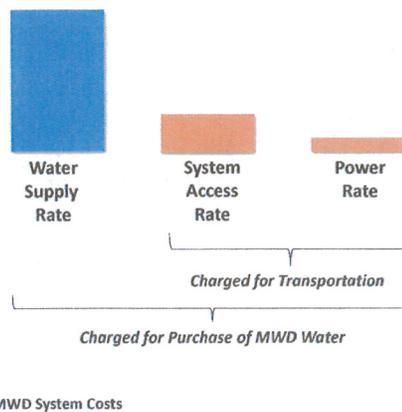
Water conserved by the All-American Canal Lining Project is an important part of the Water Authority's Colorado River water transfer supplies.

### MWD's Current Rate Structure

MWD's Rate Structure Misallocates Water Supply Costs to the Transportation Charge



### How MWD Rate Structure Should Be



For more information on this issue, visit [www.sdcwa.org/mwdrate-challenge](http://www.sdcwa.org/mwdrate-challenge)



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Water Authority

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