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

December 8, 2014

Randy Record 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 8-1: Authorize: (1) increase of $40 million for conservation incentives and (2) increase to contract authority of the five-year agreement with Electric and Gas Industries Association for administration of Metropolitan's regional conservation rebate program – **OPPOSE**

Chair Record and Members of the Board:

The Water Authority and its member agencies strongly support and have an outstanding record of leadership in water conservation planning, programs and implementation. Through our collective efforts, the San Diego region's per capita water use has been reduced by almost 25 percent since 2007. In response to the current drought, we launched our *When in Drought, Save Every Day, Every Way* campaign in order to further increase public awareness. As a result of these efforts, a recent poll shows that more than 80 percent of San Diegans now believe saving water is a civic duty. While we continue to support the Governor and State Board's call to increase conservation, we must oppose staff's recommendation due to the manner in which ratepayer dollars are being spent and the absence of any accountability or demonstration that the expenditure of these funds is actually achieving the intended purpose.

Staff's recommendation is to spend five times more than its adopted budget on conservation programs in this fiscal year alone (leaving no conservation funding for the following fiscal year).[i] Funding would come from money MWD has over-collected from ratepayers over the last two fiscal years. This money could have been invested directly at the local level, on water conservation and supply programs that would not only alleviate the impacts of drought, but also provide long term water supply benefits. Instead, MWD is proposing to spend a significant portion of this money, over-collected from all ratepayers, on turf replacement on commercial properties including private golf courses. At MWD's $2 per square foot rebate, this costs MWD ratepayers more than $1,500 per acre-foot.

Against this backdrop, we find it ironic that the MWD board just last month adopted a purchase order policy that allows MWD member agencies to increase purchases of low priced Tier 1 water (and avoid the higher Tier 2 rate on an annual basis as costs are incurred), completely eliminating the pricing signal Tier 2 was originally intended to send. MWD's "pricing signals" and behaviors - including this water conservation program - are completely upside down and inconsistent.

MWD is simply burning through ratepayer dollars irresponsibly in the name of water conservation. It could accomplish much more by structuring its rates according to its cost of service and sending true price signals about the value of water. At a minimum, before approving any further funding, MWD should redesign this program to place a cap on the amount of rebate applicants may receive so that conservation rebates are possible involving the general public and a wider range of applicants.

Given the proposed unprecedented level of spending associated with money being paid to private business, we request the General Auditor conduct a financial audit of all rebate programs, starting with a specific emphasis on the turf removal program. For the same reason, we request that the contract authority for EGIA be extended only to match the biennial budget, rather than through 2017. We believe this is absolutely essential to ensure that the MWD board of directors is being a responsible steward of ratepayer dollars.

Sincerely,

Michael T. Hogan   Keith Lewinger   Fern Steiner   Yen C. Tu

Michael T. Hogan	Keith Lewinger	Fern Steiner	Yen C. Tu
Director	Director	Director	Director

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[i] The staff letter states that the current proposed increase is "intended to address immediate issues in the conservation program for the current fiscal year." MWD's adopted biennial budget for conservation for fiscal years 2014/15 and 2015/16 was $40 million. With the addition of $20 million in February and this request to add another $40 million, the conservation budget for the current year alone would total $100 million.

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December 8, 2014

Randy Record 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 8-2: Approve adjustments to Metropolitan's Water Supply Allocation Plan -- **REQUEST TO DEFER ACTION PENDING A BOARD WORKSHOP** or in the alternative, **OPPOSE**

Chair Record and Members of the Board:

We write to request that the board defer action on the recommended adjustments to MWD's Water Supply Allocation Plan (Allocation Plan) detailed in Board Memo 8-2 pending an emergency board workshop to review a number of fiscal and policy issues discussed below; should the board decline to defer action to accommodate scheduling of a Board workshop, then we OPPOSE the recommended adjustments to the Allocation Plan.

Background: The Water Authority's delegates wrote to this Board on September 9, 2011, regarding adjustments that were then being proposed to the Allocation Plan (a copy of the September 9 letter is attached for ease of reference). Although our delegates voted to support the Allocation Plan adopted in 2008, our 2011 letter noted that the Allocation Plan was based on policy direction given by the Board in 1999. Thus, in 2011, it had already been more than 10 years since this Board of Directors had considered the policies upon which the Allocation Plan is based. We noted in 2011 that MWD's water supply and fiscal conditions had changed dramatically, but that the associated board policies had not been reviewed or updated. Now, three more years have passed without Board deliberation of these vital polices. Instead, we are presented with a list of meetings MWD staff held with member agency staff and are now advised of their conclusory recommendations, while there may be benefits for staff to discuss allocation details with member agency staff, the board must ensure that the recommendations are consistent with board policy; no data or analyses supporting how these recommendations are consistent with the MWD Act have been presented to this board.

As stated in our 2011 letter, we question whether a "need"-based approach that does not even require member agencies to achieve statutorily mandated retail conservation targets sends the right signal. Under the MWD Act, we do not believe that the Allocation Plan is enforceable in the absence of a declared water supply emergency or in the event a member agency orders a water supply within its preferential rights. Board Memo 8-2 does not reference the statutory authority pursuant to which it is adopted (we assume footnote 1 on page 1 of the Board Memo is not intended as the basis of the proposed MWD board action). MWD Act Section 135 establishes the member agency's respective entitlement to MWD water. It does not contain any additional authority for allocation of water.

The time has long since passed for this Board to review all of the relevant data and modeling that may (or may not) support the policies, assumptions and recommendations for the allocation of water during times of shortage. Consideration by the member agency staff and managers is no substitute for board deliberation. The Board must also consider how the Allocation Plan relates to other board policies and principles and legal requirements.

Separate Allocation for drought-impacted groundwater basins: We oppose adding a separate allocation for drought-impacted groundwater basins because we believe it would necessarily drive MWD into an even higher stage of shortage than currently exists and impede its ability to meet the ordinary demands and requirements of all Southern California water consumers. Instead, the needs of MWD water consumers located in these areas should be factored in to whatever allocation is made to all MWD water consumers.

The board memo confuses issues having to do with water supply allocation during times of shortage with issues associated with long-term planning to meet the replenishment needs of groundwater agencies. We don't believe any studies or consultation with MWD staff is needed to "verify" the need for groundwater replenishment; indeed, If MWD can find a groundwater basin in Southern California (or California generally) that is not in need of replenishment at this time, we would be surprised. But MWD is not charged with meeting the needs of groundwater basins; rather, it is charged with utilizing its available water supplies during times of shortage to meet the legal demand for water by its member agencies, or, take action to distribute water under Section 350 of the Water Code.

Replacing Allocation Plan penalty rates with an "Allocation Surcharge": As noted earlier, it is unclear what statutory authority MWD is relying upon in Board Memo 8-2. In any case, we do not believe that sufficient information has been provided to determine whether or not the penalty or "surcharge" meets legal requirements. We believe the current penalty pricing provision, as well as the proposed surcharge, are inconsistent with Section 135 to the extent that any member agency is assessed a penalty for an amount of water that is within its preferential right.

It is also paradoxical to eliminate the Tier Two "pricing signal," as the Board did last month in adopting changes to the "Purchase Orders," and at the same time declare the Allocation Surcharge is needed to send a "pricing signal." MWD staff and legal counsel need to go back to the drawing board on all of these policies and legal requirements so that MWD's member agencies and Southland water consumers may have more certainty about what imported water supplies they may count on receiving from MWD during times of shortage. We have expressed concerns separately regarding the merits of the turf removal funding (see Board Letter of this date RE Board Memo 8-1).

Request to give staff additional discretion to allocate water: Board Memo 8-2 recommends giving staff a wide range of discretion to adjust water supplies to be allocated to member agencies.[i] We do not support staff having discretion to determine on an ad hoc or case-by-case basis how water supplies should be allocated during shortages.

The data contained in Attachment 2 RE 2014 WSAP Member Agency Base Period and Allocation Year Data is incorrect: Water Authority staff has previously requested correction of this data to eliminate the double-counting of its Colorado River "local supplies" as also being "MWD Purchases." This reporting is not consistent with the manner in which the local water supplies of all other MWD member agencies have been accounted for.

We urge the Board to defer staff's recommendations, and instead, direct staff to schedule a board workshop to discuss changed circumstances and board policies contained in the Water Supply and Drought Management and Allocation Plans. We welcome the opportunity to work with you in preparing an agenda and approach for the Board's consideration.

Sincerely,

Michael T. Hogan
Director

Keith Lewinger
Director

Fern Steiner
Director

Yen C. Tu
Director

Attachments:

1. Water Authority's Letter to MWD on Water Supply Allocation Plan Adjustment, dated September 9, 2011
2. Water Authority's Letter to MWD on Conservation, dated December 8, 2014

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[i] Staff recommends (1) that it be allowed to establish a "consultation process" to meet with member and retail agencies regarding adjustments to the Allocation Plan Base Period and only report adjustments to the Board ex post facto; (2) to replace current defined methodology for calculating conservation demand hardening credits with an alternative methodology based on "observed" reductions and adding a new credit for "the member agency's dependence on MWD," which has nothing to do with demand hardening; and (3) a "consultation" process in which staff will decide how much water may be allocated to the "needs of groundwater basins," and including an "appeals process" in which the Board may vote to allocate additional supplies. Aside from creating even more confusion about how much water any agency may obtain from MWD during a time of shortage, MWD does not have staff available that is qualified to make the various determinations about meeting the "needs of groundwater basins," let alone deciding what is a "severe and/or inequitable financial impact."

Attachment 1

San Diego County Water Authority
4677 Overland Avenue • San Diego, California 92123-1233
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September 9, 2011

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

Re: Board Memo 8-3 –
Adjustments to Metropolitan's Water Supply Allocation Plan Formula
REQUEST TO DEFER ACTION PENDING BOARD WORKSHOP

Dear Chairman Foley and Board Members:

We write to request that the board defer taking action on adjustments to the Water Supply Allocation Plan formula as proposed in Board Memo 8-3. Instead, for the reasons described below, we request that the Chairman schedule a workshop to review board policies relating to the Water Surplus and Drought Management Plan (WSDM Plan) and Water Supply Allocation Plan (Water Supply Allocation Plan or Plan).

The Water Supply Allocation Plan was first adopted by the board in February 2008 in response to water supply challenges facing MWD and its service area during 2007, which were then described as raising – for the first time – the possibility that MWD might not have access to the water supplies necessary to meet total firm demands. The 2008 staff recommendation for the Water Supply Allocation Plan states that it was based on board principles that provided policy direction, contained in the Water Surplus and Drought Management Plan (WSDM Plan) adopted by the board in 1999. *Thus, it has been more than 10 years since the board of directors considered the policies upon which MWD's Water Supply Allocation Plan is based.* The WSDM Plan itself states that it was intended to be a 10-year plan. The WSDM Plan should have been scheduled for board review in 2009.

The board's "Guiding Principle," "Supporting Principles" and "Implementation Goals" which are the policy basis of the WSDM plan are not mentioned in Board Memo 8-3. They are included as Attachment 1 to this letter for ease of reference. The board should review and refine these principles and policies in light of the substantially changed conditions that now exist, including, but not limited to mandatory 20% retail water conservation, MWD's declining sales and a water rate environment in which conservation and local water supply alternatives have become cost-effective.

There are significant policy issues associated with how MWD allocates water during times of shortage. For example, does a "need"-based approach that does not require member agencies to achieve statutory retail conservation targets send the right message (and is it even consistent with state law)? There are many who believe that a "need"-based approach actually inhibits, rather than supports sound water supply management because it appears to punish rather than reward those who make local investments to improve water supply reliability. Many retail water suppliers simply want to know how much water they can count on receiving from MWD's imported water sources during times of shortage so that they may plan these local investments more efficiently. Encouraging such investment at the local level would also reduce the water supply investments MWD would be required to make and thus lower wholesale water rates. There is also a question whether the Water Supply Allocation Plan is enforceable in the absence of a declared water supply emergency in the event preferential rights are asserted by one or more member agencies.

As noted above, the current methodology was developed in response to conditions that were then viewed as extraordinary. But what was then "extraordinary" has become today's water supply planning reality. Supplies will continue to be constrained for the foreseeable future and water rates will continue to escalate. Although the Water Authority supported the need-based approach over the past few years with the understanding that it was a *transitional plan* to allow retail agencies to responsibly plan for the future, the MWD board must now consider the long-term policy implications of the Water Supply Allocation Plan in light of what we now know are water supply planning realities.

Although the Board Memo describes 12 meetings with the member agency managers, this is the first time the Board will have to consider the policy issues contained in the WSDM and WSAP plans. While it is certainly appropriate for staff to consult with the member agency managers as part of its due diligence in making recommendations to the board – and we do appreciate their hard work in updating the technical details of the formula – the member agency managers' review process is no substitute for the board's consideration and deliberation of the many policy issues associated with MWD water shortage allocations

We urge the board to defer staff's recommendations, and instead, direct staff to schedule a board workshop to discuss issues related to the WSDM and Water Supply Allocation plans. We would welcome the opportunity to work with you and the rest of the board in preparing an agenda of issues for the board's deliberation.

Sincerely,

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

cc: MWD Board of Directors
SDCWA Board of Directors

Attachment 1: "Guiding Principle," "Supporting Principles" and "Implementation Goals" (1999 WSDM Plan)

WSDM PRINCIPLES AND IMPLEMENTATION GOALS

The central effort in developing the WSDM Plan was a participatory process involving Metropolitan and its member agencies. Metropolitan staff and member agency representatives coordinated the Plan's development during a series of meetings of the Rate Refinement Team and the Integrated Resources Planning Workgroup. To lay a foundation for the WSDM Plan, participants in the Rate Refinement Process developed a set of "WSDM Principles and Implementation Goals."

Guiding Principle

- Metropolitan will encourage storage of water during periods of surplus and work jointly with its Member Agencies to minimize the impacts of water shortages on the region's retail consumers and economy during periods of shortage.

Supporting Principles

- Maintain an ongoing coordinated effort among Metropolitan and its Member Agencies to encourage efficient water use and cost-effective local resource programs and to inform the public on water supply and reliability issues.

- Encourage local and regional storage during periods of surplus and use of storage during periods of shortage.

- Manage and operate Metropolitan's regional storage and delivery system in coordination with local facilities to capture and store surplus water in local groundwater and surface reservoirs.

- Arrange for secure sources of additional water from outside the region for use during periods of shortage.

- Call upon sources of additional water from outside the region and water stored locally to meet the needs of consumers and protect the economy during periods of shortage.

WSDM Plan Implementation Goals

- Avoid mandatory import water allocations to the extent practicable.

- Equitably allocate imported water on the basis of agencies' needs.

  Considerations to create an equitable allocation of imported water may include:

  - Impact on retail consumers and economy
  - Reclamation/Recycling
  - Conservation
  - Population and economic growth
  - Investment in local resources
  - Change and/or loss of local supply

  - Participation in Metropolitan's Non-firm (interruptible) programs
  - Investment in Metropolitan's facilities.

- Encourage storage of surplus supplies to mitigate shortages and improve water quality.

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December 8, 2014

Randy Record 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 8-1: Authorize: (1) increase of $40 million for conservation incentives and (2) increase to contract authority of the five-year agreement with Electric and Gas Industries Association for administration of Metropolitan's regional conservation rebate program – **OPPOSE**

Chair Record and Members of the Board:

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Staff's recommendation is to spend five times more than its adopted budget on conservation programs in this fiscal year alone (leaving no conservation funding for the following fiscal year).[i] Funding would come from money MWD has over-collected from ratepayers over the last two fiscal years. This money could have been invested directly at the local level, on water conservation and supply programs that would not only alleviate the impacts of drought, but also provide long term water supply benefits. Instead, MWD is proposing to spend a significant portion of this money, over-collected from all ratepayers, on turf replacement on commercial properties including private golf courses. At MWD's $2 per square foot rebate, this costs MWD ratepayers more than $1,500 per acre-foot.

Against this backdrop, we find it ironic that the MWD board just last month adopted a purchase order policy that allows MWD member agencies to increase purchases of low priced Tier 1 water (and avoid the higher Tier 2 rate on an annual basis as costs are incurred), completely eliminating the pricing signal Tier 2 was originally intended to send. MWD's "pricing signals" and behaviors - including this water conservation program - are completely upside down and inconsistent.

MWD is simply burning through ratepayer dollars irresponsibly in the name of water conservation. It could accomplish much more by structuring its rates according to its cost of service and sending true price signals about the value of water. At a minimum, before approving any further funding, MWD should redesign this program to place a cap on the amount of rebate applicants may receive so that conservation rebates are possible involving the general public and a wider range of applicants.

Given the proposed unprecedented level of spending associated with money being paid to private business, we request the General Auditor conduct a financial audit of all rebate programs, starting with a specific emphasis on the turf removal program. For the same reason, we request that the contract authority for EGIA be extended only to match the biennial budget, rather than through 2017. We believe this is absolutely essential to ensure that the MWD board of directors is being a responsible steward of ratepayer dollars.

Sincerely,

Michael T. Hogan	Keith Lewinger	Fern Steiner	Yen C. Tu
Director	Director	Director	Director

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[i] The staff letter states that the current proposed increase is "intended to address immediate issues in the conservation program for the current fiscal year." MWD's adopted biennial budget for conservation for fiscal years 2014/15 and 2015/16 was $40 million. With the addition of $20 million in February and this request to add another $40 million, the conservation budget for the current year alone would total $100 million.

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November 17, 2014

Brett Barbre and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

RE: Finance and Insurance Committee Item 6c – Balancing Accounts

Dear Committee Chair Barbre and Members of the Board:

Thank you for placing the balancing accounts issue on the committee agenda this month.

In September, when staff last presented the item for discussion, we noted that the content of the presentation was not responsive to the question, namely, how can revenues from individual rates be tracked to improve accountability and ensure compliance with cost-of-service requirements. We are disappointed to see that the same non-responsive staff presentation will be made again this month.

The concept of balancing accounts is well-known and easy to understand. It is a long-standing accounting practice among private water utilities used to protect both the utility and its customers from changes in costs the utility has no ability to control (for example, the weather,) and at the same time, ensure that rates accurately reflect the costs of providing service. Because MWD now derives significant revenues from transportation services, it is imperative that MWD's accounting methods ensure all of its member agencies and ratepayers that the rates they are paying are fair, and used for the intended purpose as established during the public rate-setting and cost-of-service process.

We are asking that MWD implement an accounting mechanism that tracks revenues from all individual rates and expenditures associated with those rates. To the extent that MWD actual sales differ from forecasted sales, it may collect more or less than the revenue requirement upon which the rate for a particular service is determined. Discrepancies between revenue requirements and actual revenues and expenses are captured through balancing account mechanisms, which "true-up" the actual revenue to the revenue requirement in the following year. This "true-up" ensures that MWD only collects the revenue requirement for the rate that is charged in compliance with applicable law.

We do not understand why MWD would be unwilling to extend its current practice of tracking treatment and water stewardship rates to also include supply, system access and system power rates. We are asking only that MWD account for all of its rates just as it now does for its treatment and water stewardship rates. Tracking rates and revenue collection in this manner does not impede MWD's ability to meet bond covenants or any other requirement or function described in the staff presentation.

We are also concerned with the position expressed at the last committee meeting that the Water Rate Stabilization Fund (WRSF) requirements should flow into a single fund with board discretion to expend those funds on any purpose. The melding of surplus funds received from different rates and charges would necessarily lead to cross-funding of unrelated services. Furthermore, the priority for fund flows (dollars in/out) could first be to the separate fund accounts for each identified service, rather than flowing first to the WRSF, as is the current practice, or sub-account funds could be created within the WRSF to track and account for sources of the “puts” into the WRSF and the “takes” from the fund. This would ensure collections from the rate for each service are accounted for and attributed to that service. Surplus collections remaining in that account may then be used to mitigate corresponding rate increases in the following years so funds are spent for that service in accordance with cost-of-service and Proposition 26 (2010) requirements.

We look forward to discussing this important transparency issue at the committee and board meeting this month.

Sincerely,

Michael T. Hogan
Director

Keith Lewinger
Director

Fern Steiner
Director

Yen C. Tu
Director

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November 17, 2014

Randy Record 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 8-2: Authorize the execution and distribution of (1) the official Statement in connection with the issuance of the Waterworks General Obligation Refunding Bonds, 2014 Series A; and (2) Remarketing Statements in connection with remarketing of the Water Revenue Refunding bonds (Index Mode), 2011 Series A-1 and A-3, and 2009 Series A-2 – **OPPOSE**

Dear Chair Record and Members of the Board:

The Water Authority's MWD Delegates have reviewed the November 18, 2014 board memo 8-2, including the redline copy of Appendix A, and have determined we must vote against staff's recommendation to authorize the execution and distribution of the Official Statement and Remarketing Statements in connection with the refunding of bonds. While we support staff's objective to refund debt in order to reduce MWD's financial obligations, we do not believe that the bond disclosures fairly present MWD's financial position or risk. We request that staff and bond counsel respond to each of the issues and questions presented in this letter.

General Comments

At the outset, we note that a number of comments we have provided in the past have not been substantively addressed by changes in the Official Statement; we do not repeat, but incorporate herein by reference all of the issues that have been raised in prior letters that have not been substantively addressed by MWD management.

We noted in our last comment letter that MWD had abandoned its effort to conduct a comprehensive update of its 2004 Long Range Finance Plan, now more than 10 years old. Rather than continue to work with the member agencies to determine their willingness to pay MWD's long-term capital and operating costs -- an effort that was unsuccessful after five years of on again/off again "rate refinement" meetings -- MWD chose to simply "declare" that the 10-year rate forecast in its biennial budget *is* its long-range financial plan. But the biennial budget contains no reference to how MWD will ensure a sustainable revenue source from its member agencies to support MWD's projects and programs in the long term. The draft Appendix A fails to disclose that MWD has not been successful in its efforts to develop long-term revenue commitments to pay for long-term water supply investments.

The Draft Appendix A also fails to disclose the unusual manner in which MWD is now establishing its budget and its rates, based not on actual projected water demand nor projected expenses, but on the basis of an arbitrary number that MWD itself expects to exceed in seven out of 10 years. This approach fails to even attempt to meet cost-of-service requirements in setting MWD's rates and charges, and instead, results in intentional, systematic revenue over-collection from MWD ratepayers, with ex-post facto decision-making by the MWD board of directors on how to spend the intentionally over-collected rate dollars without any cost-of-service standard of transparency, accountability or legality.

MWD also fails and refuses to track or account for revenues it receives from the different rates it charges for the services it provides. For this reason, it cannot and does not ensure that rate revenues are spent on the intended purposes. For example, funds over-collected from the System Access Rate and System Power Rate are being used to pay for water conservation programs that benefit supply service customers, rather than being used to set lower transportation rates in the following year. The cross-subsidy between services can be demonstrated by the fact that even though data stated in A-91 indicates MWD "water sales" (in which MWD improperly includes revenues from the transportation service it provides to the Water Authority) exceeded budget in five fiscal years between 2004/05 and 2013/14. In reality, MWD's actual water sales (i.e., not including revenues from the Water Authority's transportation service payments) exceeded budget in only three of those years. Unlike water demand, which is inherently more difficult to predict, MWD revenues from the transportation service it provides to the Water Authority are entirely predictable and do not vary because of hydrology. MWD's practice of comingling revenues from the different rates it charges causes illegal cross subsidies and results in rates that do not bear a reasonable relationship to the costs of providing a particular service. Each and every one of these practices results in illegal rates being charged by MWD.

Comments on Draft Appendix A

All references are to the page numbers in the draft redline copy of the Appendix A dated 11/06/14.

A-4: Drought Response Actions. The discussion in this section of the Official Statement is insufficient to advise a reader of the risks associated with MWD's dwindling imported and stored water supplies given the possibility of a continuing drought. The fact that MWD is projected to use between 1 million acre-feet (MAF) to 1.3 MAF of its available storage reserves in calendar year (CY) 2014 alone is material. While MWD notes that it declared a Water Supply Alert last February and doubled its conservation subsidy budget, it does not mention that these efforts have thus far failed to reverse the demand trend that will result in the consumptive use of more than one-half of its available storage reserves in 2014.

Appendix A should discuss and disclose how MWD plans to meet 2015 demands under these circumstances in the event that the drought continues. MWD should provide supporting facts, operational projections and the assumptions used to support its statement that the Colorado River Aqueduct is expected to operate at capacity, given that it projects that it will exhaust the bulk of its Lake Mead water storage in 2014. The analysis should include consideration of any delivery limitations MWD may experience in areas served exclusively by the State Water Project as well as MWD's plan to ensure that emergency storage reserves are preserved for their intended purposes (i.e. providing water service following a catastrophe that cuts off imported water supplies).

A-5: Integrated Water Resources Plan. Appendix A should disclose that it would be imprudent to make any long term water supply planning decisions based on the badly outdated 2010 Integrated Resources Plan (IRP). Although the Draft Appendix A mentions that the IRP is scheduled to be updated in 2015, it does not disclose the risks of continuing to make decisions based on outdated data that is known to MWD today – a material deficiency. Moreover, MWD has not even begun to conduct the necessary coordination with member agencies to update the plan. In the past, it has taken MWD about two years to complete the update. Without having a current long-term supply plan and accurate data taking into account changed circumstances, MWD is at risk of committing to pay for long-term water supply projects in excess of what its member agencies are willing to buy. The IRP also assumes that MWD will have revenues available from water rates that have been declared illegal. MWD has claimed in court filings that this has a "destabilizing effect on MWD's rates and its ability to budget and plan" (our December 9, 2013 letter is attached for your ease of reference; see pages 1-3 (Dec. 9 Letter)). If MWD actually believes its own representations to the Court, then this should be disclosed.

A-7: State Water Project. Appendix A should disclose that the Agreement in Principle reached to extend the State Water Project contract does not address cost allocation related to the Bay Delta Conservation Plan (BDCP). Depending on how BDCP costs are proposed to be allocated, MWD's share of the BDCP could vary widely and have a substantial impact on MWD's water rates and charges, and as a result, have a substantial impact on reducing MWD's future water sales. Since it is expected that the financing of BDCP will continue to be under a take-or-pay contract, MWD is at risk of being liable for payments far in excess of revenues that may reasonably be anticipated from water sales. In such a case, MWD would have no alternative but to find that increased taxes are necessary in order to ensure its fiscal integrity. These fiscal realities are capable of being addressed, and should be addressed in the Draft Appendix A.

A-15: Water Bond. Appendix A should disclose that the Water Bond will provide funding for local water supply projects that are anticipated to reduce demand for MWD water supplies.

A-32: Water Supply Allocation Plan. We have previously requested that disclosures be made regarding Preferential Rights that have not been made (Dec. 9 Letter, page 4). We renew our request that a more complete discussion of preferential rights be included in Appendix A. Disclosure should also be made of recent actions and communications from MWD member agencies with regard to enforcement of their preferential rights and the impact such actions would have on MWD's water supply planning, supply allocation and drought response.

A-49: Metropolitan Revenues: General. The MWD Act clearly limits property tax collections to the amount necessary to pay annual debt service on MWD's general obligation bonds, plus the portion of its State Water Contract payment obligation attributable to the debt service on State general obligation bonds for facilities benefitting MWD *that were outstanding as of 1990-91*. It is misleading to delete the qualifying language, "that were outstanding as of 1990-91." MWD should disclose that its own Chief Financial Officer, Gary Breaux, informed the MWD board prior to its vote in August of this year suspending the tax rate limitation that the action was *not* essential to the fiscal integrity of MWD. The action by the MWD board in suspending the tax rate limitation does not comply with Section 134 of the MWD Act. Further, it should be disclosed that the MWD board did not engage in any substantive discussion or deliberation of alternatives in order to achieve a "fair distribution of costs," and was provided with no data to support the conclusory statement by staff that suspension of the tax rate limitation would "enhance MWD's fiscal stability" or result in "a fair distribution of costs across MWD's service area."

A-53: Delta Supply Surcharge. The Delta Supply Surcharge was, as stated, designed to recover additional supply costs associated with pumping restrictions. Appendix A should disclose the financial risks associated with the board's suspension of the Delta Supply Surcharge, even though the pumping restrictions remain in place, especially in the context of the staff recommendation to change the terms of MWD purchase orders (action this month) to eliminate Tier 2 revenues, the original purpose of which was also to recover the high cost associated with obtaining additional water supplies. Both actions result in setting the Tier 1 water rate higher than the cost of providing that service. There is no rational basis for MWD reducing the rates associated with the costs of obtaining additional water supplies.

A-56: Member Agency Purchase Orders. Appendix A should disclose the purchase order modifications recommended by staff to be considered this month, including the financial impacts and risks associated with the elimination of MWD's Tier 2 revenues. MWD should also disclose that, during the trial of the Water Authority rate cases, MWD represented that Tier 2 revenues were a mechanism to ensure that all MWD member agencies pay their fair share of dry-year peaking costs. Since there has been no change in MWD's rates or cost of service, there is no explanation of how these costs will now be recovered except in the form of another illegal cross-subsidy.

A-56: Classes of water service. This section of the Draft Appendix A is inaccurate and materially misleading in several respects. First, MWD has multiple rates, including a Water Stewardship Rate, System Access Rate, and System Power Rate and Wheeling Rate. MWD also sells treated and untreated water. The costs that MWD incurs to provide these and other services, such as dry-year peaking, are not the same for all MWD member agencies. These differences are required to be identified and the associated costs properly allocated through a cost-of-service process to ensure that beneficiaries pay for the services they receive. MWD's simplistic statement that it has a single class of water service is not only inaccurate; it results in rates that are illegal under California law and exposes MWD to the continued risk of litigation.

A-58: Readiness-to-service Charge. Having disclosed that the RTS recovers only a portion of capital expenditures for infrastructure projects needed to provide standby service, Appendix A should also disclose how the remaining portion of these capital costs are recovered. In addition, the statement that the RTS recovers capital expenditures related to "peak conveyance" needs is inconsistent with MWD's rate memo; please explain this discrepancy and correct for it in one or both documents.

A-59: Financial Reserve Policy. MWD should disclose that the MWD board does not have unlimited discretion to determine how revenues are spent, through the creation of reserves, or otherwise; rather, all of MWD's rates and revenues are subject to California cost-of-service requirements under the common law, California statutes and Constitution. The planned over-collection of revenue and refusal to utilize balancing accounts or any other mechanism to account for and track revenues by rate category subjects MWD to the further risk of litigation.

A-62: Ten Largest Water Customers -Water Sales Revenues. It is highly misleading to characterize wheeling revenues as MWD "water sales." We have requested many times that you correct this summary so that investors are not required to figure out by reference to a small footnote that MWD's water sales are not as high as described.

A-63: California Ballot Initiatives- Proposition 26. Appendix A should include disclosure of the fact that Judge Curtis E.A. Karnow has already ruled that MWD is subject to Proposition 26 (2010). MWD should also disclose how or why, if it is not now subject to Prop. 26, it could "affect future water rates and charges."

We incorporate by reference all of our prior comments in prior letters to MWD that have not been corrected in this or past versions of the Official Statement.

Sincerely,

Michael T. Hogan Keith Lewinger

Michael T. Hogan Director	Keith Lewinger Director	Fern Steiner Director	Yen C. Tu Director

Attachment: Water Authority Comment Letter on MWD Draft Official Statement, dated 12/9/13

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

December 9, 2013

John (Jack) V. Foley 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 8-1: Authorize the execution and distribution of Remarketing Statements in connection with the remarketing of the Water Revenue Refunding Bonds (Index Mode), 2011 Series A-1/A-3 and 2009 Series A-2

Dear Chair Foley and Members of the Board:

We have reviewed the December 10, 2013 Board Memo 8-1 and the redline copy of Appendix A, and have determined we must again vote against the staff recommendation to authorize execution and distribution of the Official Statement in connection with the sale of bonds. We request that staff and bond counsel respond to each of the issues and questions presented in this letter.

General Comments

At the outset, we note that a number of comments we have provided in the past have not been substantively addressed by changes in Official Statement; we do not repeat all of the points here, but have included a list of our letters[i] (copies of which have previously been provided to the MWD staff and board) at the end of this letter and incorporate herein points not previously addressed by MWD management.

All references are to the page numbers in the draft redline copy of the Appendix A dated November 25, 2013.

Inconsistent statements by MWD in its Official Statement and pleadings filed in Court. In describing the litigation challenging MWD's rates, the Official Statement states that,

> "to the extent that a court invalidates Metropolitan's adopted rates and charges, Metropolitan will be obligated to adopt rates and charges that comply with any mandates imposed by the court. Metropolitan expects that such rates and charges would still recover Metropolitan's cost of service. As such, revenues would not be affected." (A-54)

In stark contrast to this representation, MWD has alleged in court filings that the Water Authority's lawsuit (or any member agency litigation) has a "destabilizing effect on MWD's rates and its ability to budget and plan." Further, that if the Water Authority were to prevail, it would, "threaten the current funding source for existing LRP, CCP and SDP project contracts and threaten future LRP, CCP and SDP contracts." Indeed, the impacts of the "destabilization" described in MWD's declarations and pleadings filed with the court is so great that MWD has alleged that it cannot ensure the continued administration of these programs or any of the long term investments described in its IRP if it should be required to change the cost allocation to its rates. See, for one example among many, the Upadhyay Declaration in Support of MWD's Opposition to SDCWA's Motion for Summary Adjudication at pages 7-8, (excerpt attached). Similarly, MWD's recent motion to exclude testimony by one of the Water Authority's experts states that, were the Water Authority's "proposed reallocation [of costs] to occur, member agencies would buy less water from MWD." Motion to Exclude Denham at pages 9-10 (excerpt attached).

There is no way to reconcile MWD's statements to bondholders on the one hand, and to the Court, on the other. It cannot at the same time be true that the Water Authority's rate litigation will have no impact on MWD's revenues, and at the same time, "destabilize" MWD and threaten its water supply programs and ability to budget and plan.

The real risk of destabilization. While we disagree as to the cause (it is not the result of the exercise of free speech by any member agency), we do believe that MWD is threatened by the kind of "destabilization" described in its court filings *as a result of its failure to have in place a long range finance plan and commitments by its member agencies to pay for the billions of dollars MWD is spending and plans to spend in the future.* This is not a new issue; it was well-described by an independent Blue Ribbon Task Force almost 20-years ago:

> *Reliability, quality and other water supply specifications cannot be made independently from the willingness of MWD customers to pay for such services*. Member agencies may want, for example, the insurance provided by major investments to increase MWD standby capacity, but if forced to commit funds for such capabilities, they may actually prefer far lower levels of protection than a hypothetically "costless" water supply guarantee. (page 9; emphasis in original)
>
> *Derive IRP results starting from a willingness to pay perspective as well as from reliability and supply goals to assess whether current planning efforts adequately "loop back" and force the reappraisal of initial reliability and other operational assumptions.* Member agencies, and other water users, may have a desire to improve reliability and performance capabilities beyond their willingness or ability to pay for such improvements. In the event of substantial divergences in various water users' willingness to pay for MWD capacities, Metropolitan may wish to consider more flexibly pricing wholesale

> water supplies to reflect the levels of reliability and cost burdens that each user desires and is willing to bear. Effective planning can only occur after the maximum level of current and future investment member agencies will bear has been determined. (page 14; emphasis in original)
>
> *The peaking charge should recover the actual economic costs generated by peaking behavior and not be set by political considerations.* (page 21; emphasis in original)
>
> …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. The wide variation in member agency local water supply and project options means that each agency will differently value MWD water and facility investments, a fact that can frustrate needed revenue agreements…[t]he Task Force was troubled to learn…that some of the member agencies most strongly supporting big-ticket projects…also had the most aggressive plans to reduce their future MWD water purchases and develop independent supplies. In effect, such agencies appear to want MWD to develop costly backup capacity-or insurance-for their local supply strategies, while seeking to shift the costs for these benefits on to Metropolitan and other agencies and consumers. (page 23)

We have raised these issues repeatedly in the boardroom and in past letters commenting on MWD's Official Statements. Among all of the concerns we have, the single greatest concern is MWD's failure to describe in its Official Statement, the risk associated with its continued spending at the same time ***its member agencies are clearly unwilling to commit to pay for its programs.*** We also believe that the extraordinary lengths MWD and its member agencies are going to in order to impede the development of water supplies in San Diego, independent of MWD, is information that should be made available to bond counsel (it has not been) as well as present and future purchasers of MWD bonds.

Comments on Draft Appendix A dated November 25, 2013

A-1 *Uniform rates for each of class of service.* Appendix A states that, [m]ember agencies request water from Metropolitan…*and pay for such water at uniform rates established by the Board for each class of service*" (emphasis added). This is the only place in Appendix A where the words, "class of service" are used. Please confirm whether the water "categories" described at A-57-58 are the "classes of service" referred to in the recital at page A-1.

A-6 *Standby or "dry-year peaking" demands of MWD member agencies.* Due to the compartmentalization of the disclosures in Appendix A, the reader might fail to associate the withdrawals from storage described in the last paragraph on page A-6 with the Water Authority's rate litigation; specifically, the issue of MWD's failure to account for or properly allocate the costs associated with having almost 6 million acre-feet of storage capacity and more than 3.3 million acre-feet of stored water available for withdrawal, which made possible the 300,000-500,000 acre-feet of water supply that MWD expects to draw upon to meet demands in 2013. The long-term negative impacts on MWD from its failure to identify and account for these costs are described in the Blue Ribbon Task Force Report, in the above excerpts and other portions of the Report. Appendix A should be revised to include a full discussion of this issue including potential impacts on MWD sales and rates.

A-11 Area of Origin litigation. Please provide us with a copy of the settlement agreement that is "currently being circulated among the parties for signature."

A-18 Second supplemental agreement with Coachella. Please provide a copy of the second supplemental agreement with CVWD referred to in the second full paragraph.

A-28 Storage capacity and water in storage. What accounts for the reduction in the storage numbers since last reported in May 2013?

A-30 Preferential rights and water supply allocation plan. The second full paragraph under Water Supply Allocation Plan should be revised to include disclosure that – except in a water shortage emergency declared by the MWD board under Section 350 of the Water Code (which has never happened), or any other statutory basis MWD may believe would support limitations on the exercise of preferential rights – the MWD board has no statutory authority or ability whatsoever to diminish the statutory preferential right to water held by each of its member agencies. It is highly misleading in the context of current water rates and realities to state that, "historically, these rights have not been used in allocating Metropolitan's water." The historical record is clear that the cities of Los Angeles and Long Beach have every intention of calling upon their respective preferential rights to water should it be advantageous for them to do so. The Water Authority does not question these rights, which have also been confirmed by legal opinions of MWD's General Counsel and the Court of Appeal.

A-32 Impact on MWD sales of Los Angeles updates reported in Appendix A. Two significant changes are made to Appendix A regarding the City of Los Angeles. First, that its "favored son" agreement executed by Ron Gastelum without the knowledge or consent of the board of directors, is expected to be completed six years sooner than previously disclosed. Second, that LADWP has reached a "major agreement" regarding future dust control on portions of Owens Lake. Please explain what has changed in the implementation of the AVEK agreement that accounts for the project now being completed before the end of next year (versus 2020 as previously reported in Appendix A). Please explain the impacts on MWD water sales as a result of each of these developments.

A-33 Local water supplies. The discussion of local water supplies generally is very confusing because it does not make clear to the reader what supplies are being developed by MWD (or with subsidies from MWD) and which are not. There should also be a discussion here that ties in to later sections of the Appendix A disclosing the impact on MWD sales from the development of local water supplies by the member agencies (with and without subsidies from MWD).

A-34 Impact on MWD sales of Carlsbad seawater desalination project. We were unable to confirm whether MWD's future sales projections take into account the 48,000-56,000 acre feet of water supply expected to come on line in 2016. Please identify where that accounting is made.

A-35 MWDOC application for MWD subsidies for a seawater desalination project. Please provide us with a copy of the application. Also, please provide an analysis (facts) of the regional benefits MWD believes would support the payment of such subsidies.

A-42 Discussion of MWD's capital investment plan (CIP) illustrates the need for a long range finance plan and updated cost of service analysis. The short CIP discussion reflects the wild fluctuations as a result of poor estimations by MWD staff of capital spending and the need for pay-as-you-go funding and water rate increases. Every one of these highly inaccurate estimations results in further distortion of MWD's already improper allocation of costs to its member agencies and all MWD ratepayers. It is also unclear – except possibly for litigation purposes – why MWD is claiming that it will spend zero dollars on "supply" over the next five years. Please advise whether the words, "Cost of Service," are used in a rate-setting context or, is intended to have some other meaning in this section of the Appendix A. Also, please advise why debt service for bonds MWD did not issue and does not expect to issue is included in the financial projections.

A-49 Risk management discussion is incomplete. As stated in multiple prior letters, we remain concerned with the inadequacy of MWD's overall risk disclosure. Many of the issues we have raised have not been addressed in the Appendix A. In particular, we remain concerned that MWD's long range finance plan is materially out of date (last updated in 2004). The draft Appendix A does not disclose that MWD is operating (by choice) without a long range finance plan because, after more than five years of working on it, MWD abandoned the effort (i.e., its member agencies could not agree on a long range finance plan to pay MWD's costs). Nor does MWD (by choice) have water rate projections that take into account and plan for all of MWD's projected costs and liabilities. These costs include, for example, some reasonable estimate of BDCP costs, other water supply programs included in the IRP, facility investments and retiree health. Almost 20-years has passed since the Blue Ribbon Task Force wisely cautioned MWD to develop and implement a plan for its fiscal sustainability; yet today, there remains ***no plan*** for how MWD expects to pay its costs over the long term. MWD's current ad hoc approach to financial planning is neither advisable nor sustainable and its continued spending creates a risk for all of Southern California including all of its bondholders.

A-50 MWD's actions in 2013 suspending the tax limitations in the MWD Act were not factually or legally justified. It is ironic that MWD chose to increase taxes (the net economic effect of suspending the limitation) at the same time that it was awash in cash from the over-collection of revenue from Southern California's water ratepayers. In June 2013, when MWD took the action to suspend the tax limitations, it had already collected $314 million more than needed to pay 100% of its budgeted expenditures and caused its reserves to exceed maximum reserve level by at least $75 million (see the Water Authority's June 5, 2013 letter RE Board Memos 8-1 and 8-2). As a matter of fact, additional tax revenue was most assuredly ***not*** "essential to the fiscal integrity of the district." The MWD board did not and could not make the findings necessary to support the suspension of the tax limitation, and any suggestion that the board considered in any meaningful or substantive way "factors" including the "balancing of proper mechanisms" for funding current and future State Water Project costs is unsupported by the record. If there is any document or record you believe supports this statement in the Appendix A other than the board memo, please provide copies to us in your response to this letter.

A-51 Wheeling revenues as an MWD "water sale." The Water Authority does not purchase its IID or canal lining water from MWD; it pays MWD to convey the water to San Diego. MWD's representation of these revenues as "water sales" are made for purposes of litigation only and are misleading bondholders, MWD's "disclosures" in the footnotes to its Summary of Receipts by Source notwithstanding.

A-52 Member agency purchase orders. The description of member agency purchase orders is misleading because it suggests that MWD's member agencies have made firm commitments to purchase water from MWD in the future when they have not. See discussion of this issue in prior letters commenting on the Appendix A.

A-53 Rate structure. Representations that uniform rates are collected "for every acre-foot of water conveyed by Metropolitan" are inaccurate because the rates do not take into account all of the discounted and special agreements MWD affords some but not all of its member agencies. Moreover, MWD fails to comply with cost of service legal requirements and its own act because it fails to properly acknowledge or account for different classes of service it provides to its member agencies (see comment at A-1 above, the only place in the Appendix A in which MWD mentions classes of service).

A-54 Litigation challenging rate structure. See general comments about the inconsistency between representations in the draft Appendix A and representations made to the Court.

A-60 Hydroelectric power recovery revenues. Why have the three paragraphs been deleted?

A-79 Tax increase to pay for additional payments under the State Water Contract. Please provide a copy of the opinion of MWD's General Counsel referred to in the first full paragraph that the tax increase as described would be within the exemption permitted under Article XIIIA of the State Constitution as a tax to pay pre-1978 voter approved indebtedness.

A-86 *Projected revenues and expenditures.* See question above, at A-34. Do these revenue projections assume that the Carlsbad seawater desalination facility comes on line in 2016? See also the questions above, at A-32. What assumptions are made about water sales to LADWP?

A-89 *Long range finance plan.* MWD's reserve policies are outdated, just as its 1999 Long-Range Finance Plan is. Is MWD staff relying upon and implementing all of the policies in the 1999 plan at this time?

Again, we incorporate by reference all of our prior comments which have not been corrected in this or past versions of Appendix A.

Sincerely,

Michael T. Hogan Director	Keith Lewinger Director	Vincent Mudd Director	Fern Steiner Director

Attachments
1. Declaration of Deven Upadhyay (excerpt), December 3, 2013
2. Motion to Exclude Testimony of Daniel A. Denham (excerpt), December 10, 2013

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

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[i] Water Authority comment letters on MWD's Official Statement dated: 9/22/2010, 12/9/2010, 5/16/2011, 8/22/2011, 2/13/2012, 4/9/2012, 6/11/2012, 8/20/2012, 8/29/2012, 10/8/2012, 11/5/2012, 2/11/2013, 5/13/2013, and 6/7/2013

were "to improve regional water supply reliability and avoid or defer MWD capital expenditures" and to meet "IRP local resource targets[.]" In that letter, SDCWA also recommended that MWD pay $250 per acre-foot of water under the project contracts to "reduce future MWD capital expenditures and water supply costs."

III. MWD's Integrated Rate Structure

26. MWD funds its demand management programs through revenue generated by its current, integrated rate structure which was adopted by MWD's Board of Directors in October 2001 and implemented as of January 2003 ("Existing Rate Structure"). Specifically, MWD's Water Stewardship Rate is set to recover costs related to its LRP, CCP, and SDP programs.

27. Piecemeal legal and/or legislative challenges to MWD's Existing Rate Structure would create a destabilizing effect on MWD's rates and its ability to budget and plan. This is the case because such challenges do not account for MWD's overall costs and policy considerations in setting its rates. In contrast, challenges to MWD's Existing Rate Structure within the Board process would allow for consideration of the larger picture by all of the relevant stakeholders. As a result, such challenges would not threaten to destabilize MWD's Existing Rate Structure in the way piecemeal legal and/or legislative challenges would. The RSI provision therefore protects the stability of MWD's Existing Rate Structure by encouraging resolution of rate disputes within the Board process.

28. Piecemeal legal and/or legislative challenges to MWD's rates that threaten to destabilize MWD's Existing Rate Structure also threaten the current funding source for existing LRP, CCP, and SDP project contracts and threaten future LRP, CCP, and SDP contracts. Without a stable rate structure, MWD cannot ensure the continued administration of the LRP, CCP, and SDP programs.

29. MWD relies on a stable rate structure to adequately plan, develop and budget for LRP, CCP, and SDP projects and its other capital and operating costs. MWD's MAs rely on a stable MWD budget and rate structure to plan their budgets and to set their rates. Challenging MWD's rates outside the Board process is the type of destabilizing effect the RSI provision is aimed at preventing. This kind of destabilization interjects uncertainty that interferes with long-

term planning and budgeting that is necessary to enter into the long-term LRP, CCP, and SDP project contracts. For example, if MWD were required to eliminate its Water Stewardship Rate, MWD would have to make fundamental changes to its Existing Rate Structure. In particular, absent changes in MWD's budgeted costs, MWD would have to increase its other rates to cover the cost of existing LRP, CCP, and SDP programs. This kind of unplanned for rate increase would interfere with MWD's and its MAs' ability to properly plan and budget for the future. To avoid such disruptive rate increases, MWD's Board would have to consider the possibility of having to decrease or discontinue its future investments in local conservation and resource development projects. This kind of uncertainty also inhibits MAs from investing in long-term projects that MWD needs to meet its long-term goals set forth in MWD's IRP.

30. SDCWA's assertion that MWD has the ability to reset its rates and adjust its rate structure to meet its costs does not obviate the need for the RSI provision. Resetting of MWD's rates is exactly the type of destabilization that the RSI provision was intended to prevent. Even if MWD's overall revenues would not be affected by a challenge to MWD's Existing Rate Structure, that does not mean that a challenge to MWD's Existing Rate Structure would not affect the revenues allocated to any particular program or service, including revenues available for MWD's demand management programs.

31. SDCWA suggests that the RSI provision is unnecessary because MWD could have simply increased its fixed rate charges to "provide a measure of revenue stability." The RSI provision is not aimed at protecting MWD's "revenue;" rather, it is intended to protect the stability of MWD's Existing Rate Structure to ensure continued funding of the LRP, CCP, and SDP programs, not some other, alternative hypothetical rate structure that MWD's Board did not adopt.

on MWD's supposed breaches of the Exchange Agreement. West Dec., Ex. H; *see also* West Dec., Ex. I at 332:22-333:20 (Mr. Cushman testifies that he has is testifying as to topics 7 and 8 in Metropolitan Water District of Southern California's Amended Notice of Deposition of Person Most Knowledgeable for San Diego County Water Authority (Exchange Agreement), concerning alleged breaches of the 2003 Exchange Agreement). He testified that there is no way to know what MWD's rate structure would look like if this Court accepts SDCWA's argument that State Water Project costs and the Water Stewardship Rate should not be allocated to MWD's transportation rates, or whether such a revised rate structure would be any more favorable to SDCWA than the current one:

> Presuming the Water Authority prevails [in the litigation], the judge will invalidate Metropolitan's rates, and Metropolitan will have to go back and set and adopt lawful rates. How Metropolitan goes back and adopts lawful rates and charges is at this point unknown. So how it might affect the Water Authority's payments is unknown.

West Dec., Ex. I at 443:20-444:2

Mr. Denham's assumption that MWD's rate structure would otherwise remain the same if State Water Project and Water Stewardship costs were moved from transportation rates to supply rates is completely speculative, which renders his opinion inadmissible. *Biren v. Equal. Emergency Med. Grp., Inc.*, 102 Cal. App. 4th 125, 138 (2002) ("Damage awards may not be based upon the testimony of experts who rely on speculation.").

Indeed, this assumption is not only speculative, Mr. Denham's admissions and basic economics refute it. Mr. Denham admits that, were these costs reallocated from transportation to supply as his report envisions, many member agencies will pay more overall for water obtained from MWD.[4] West Dec., Ex. B. at 183:12-15 ("It's reasonable to assume, as I've previously

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[4] Member agencies' rates would inevitably increase if State Water Project costs and the Water Stewardship Rate are moved wholesale into the supply rate. This is because, under Mr. Denham's assumptions, MWD would collect substantially less revenue for providing SDCWA with Exchange Water, while the rest of MWD's business -- including its revenue from other sources and its total operating costs -- remains unchanged. MWD is under a legal obligation to recover its costs through the rates it charges. *See* MWD Act § 134 (requiring MWD to set water rates at a level which will recover MWD's operating costs).

mentioned that the misallocated components go to supply. And with the supply rate going up, member agencies pay more . . . ."). Mr. Denham admits the existence of price elasticity, which in this context indicates that as MWD's rates increase, member agencies will buy less water from MWD. *Id.* at 171:22-25 ("Q. And you agree with the concept that all else being equal, the quantity of a demand good falls when the price of a good rises, correct? A. That's correct."). He also admits that MWD member agencies -- particularly one of its largest, the City of Los Angeles -- exhibit such price elasticity with regard to their water purchases from MWD. *Id.* at 174:13-22.

Thus, logically, were Mr. Denham's proposed reallocation to occur, member agencies would buy less water from MWD. If that occurred, MWD would likely have to adjust its rate structure to address depressed sales, since it must recover all its costs through its rates. Mr. Denham's opinion addresses this problem by simply pretending it does not exist:

> Q. But you didn't take this [effect of price elasticity] into account at all on your expert report, did you? A. I did not. MR. BRAUNIG: Objection; vague and ambiguous. THE WITNESS: That's not what I was asked to do.

Id. at 172:1-6. To the contrary, he assumes that the quantity of water purchased by the other member agencies will remain static,[5] even as the price increases:

> Q. So you were asked to assume that prices remain -- that sales volumes would remain the same although prices went up? A. I -- MR. BRAUNIG: Objection to the form. BY MR. WEST: Q. Yes? A. Yes, all things would remain equal.

Id. at 172:8-15. Here again, Mr. Denham's opinion rests on a key assumption that he admits is false. Thus, Evidence Code Section 803 requires that the opinion be excluded. *See Maatuk v.*

[5] For each calendar year 2011-2014, Mr. Denham divided MWD's "revised" revenue requirements by the total number of acre-feet estimated to be sold to member agencies in that year -- *e.g.*, in 2011: "When MWD's revenue requirement of $453,296,142 for these cost elements **is spread over the total number of acre-feet in the 2011 sales assumptions contained in the COS Report**, a bundled credit of $236/AF should be returned to the Water Authority, or $33,805,324 as an overcharge for transportation in calendar year 2011." West Dec., Ex. A, at Ex. B Thereto (Denham Report), 7 (emphasis added). He performed the same calculation for 2012, 2013, and 2014 -- again using sales assumptions contained in the Cost of Service Reports for those years -- and then added together the results to arrive at a total "overcharge" of $188,340,476. *Id.*

San Diego County Water Authority
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November 17, 2014

Randy Record 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 8-1 - Approve the proposed terms for Purchase Orders with Member Agencies; authorize the General Manager to execute Purchase Orders with Member Agencies consistent with the proposed terms; and approve the Proposed Amendments to the Administrative Code **– OPPOSE**

Dear Chair Record and Board Members,

We have reviewed Board Memo 8-3, the November 17, 2014 PowerPoint Presentation and documents provided to the Board at the July 7, September 8 and October 13 Finance and Insurance Committee meetings. No other information or data has been provided by staff at the three Member Agency Manager Meetings listed on page 2 of the PowerPoint (July 11, September 12 and October 17) to support the conclusions stated in the Board Memo.

New board members may not be aware that the two-tiered pricing structure and Purchase Order date back to the October 16, 2001 board action approving the rate structure proposal that remains in place today (a copy of the October 16, 2001 Board Memo 9-6 (Rate Structure Board Memo) is attached for ease of reference). At that time, MWD management stated that the purpose of the two-tiered pricing structure was to encourage efficient water resource management and conservation (Rate Structure Board Memo at page 1). Further, the board action specified that the Tier 2 Supply Rate "would be set at a level that reflects Metropolitan's cost of acquiring new supplies" (Rate Structure Board Memo at page 2, paragraph A; Attachment 1, Page 4 of 6, paragraph A; and Attachment 1, page 6 of 6 at paragraph A [*Addressing New Demands*]). The Board Memo further stated that the benefits of the rate structure included:

> ***Tiered supply rates provides (sic) pricing signals for water users with increasing demands and incentives to maintain existing local supplies.***
> Tiered water supply rates: (1) reflect higher costs of new MWD supply development; (2) signals users when local resources development and conservation might be more cost-effective; and (3) passes appropriate costs

> of new supply development to those member agencies that rely on MWD for growing demands (Rate Structure Board Memo at Attachment 1, Page 2 of 6).

The Purchase Order request form was also part of the new rate structure adopted by the board as a means to implement the tiered pricing structure.

This month's Board Memo 8-1 describes the Purchase Orders as an "adjunct" to the cost-of-service study, "in that they implement MWD's tiered supply pricing structure." *But there is no reference whatsoever in MWD's cost of service study to substantiate any linkage between cost of service and the newly proposed terms of the Purchase Order.* Indeed, the newly proposed terms stand in stark contrast to the terms and objectives described in 2001.[i] Now, instead of recovering the cost of acquiring new supplies through the Tier 2 rate, MWD proposes to allow its member agencies to buy more water than it has available to sell at the lower Tier 1 rate.[ii]

The Purchase Order is clearly not based on cost of service, because the costs of acquiring new water supplies that Tier 2 was intended to recover have not just disappeared; they are simply being shifted -- without any data or cost-of-service analysis -- to MWD's other rates and charges (for which no cost-of-service study has been performed).

Lastly, and regrettably, the Purchase Order does nothing to provide any meaningful level of financial stability for MWD as it embarks on expensive new water supply development programs. MWD's own staff has admitted as much.[iii] This is noteworthy given that the MWD board suspended its tax rate limitation twice in the past few years claiming it was necessary to ensure MWD's “fiscal integrity.” Rather than developing a long-term finance plan and rates that can provide the financial stability MWD needs, MWD is now moving in exactly the opposite direction.

It is long past time for MWD and its board of directors to return to the difficult, but necessary process of developing a real long-term finance plan to support MWD's future water supply investments. Execution of Purchase Orders with these terms by the member agencies, as recommended by MWD management, will do nothing to achieve that objective.

Sincerely,

Michael T. Hogan
Director

Keith Lewinger
Director

Fern Steiner
Director

Yen C. Tu
Director

Attachment: MWD Board Memo 9-6, dated 10/16/01

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[i] MWD has adamantly maintained that it has not changed its rate structure or rates since they were adopted in 2001; however, for the reasons stated in this letter, it is not possible to reconcile the 2001 objectives of the Tier 2 rates (and the associated costs) as described in the Rate Structure Board Memo with the Purchase Order terms recommended in Board Memo 8-1.

[ii] Total sum of Tier 1 maximum for member agencies would be 2.05 MAF, according to this month's memo.

[iii] In September Finance and Insurance committee, CFO Gary Breaux said that the purchase order "from a year-to-year standpoint, it doesn't provide that much stability."

MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

BOARD ACTION

- **Board of Directors**

October 16, 2001 Board Meeting

9-6

Subject

Approve Rate Structure Proposal

Description

Background

On September 10, 2001, the Subcommittee on Rate Structure Implementation (Subcommittee) considered a proposal by several member agency managers (Calleguas Municipal Water District, Eastern Municipal Water District, the City of Los Angeles, Central Basin Municipal Water District and West Basin Municipal Water District) to implement Metropolitan's new rate structure in a manner consistent with the Rate Structure Action Plan that was adopted by the Board in December 2000. This proposal addressed many of the concerns raised by Board members during the past nine months as the Subcommittee reviewed the December Action Plan, including the use of property taxes, financial impacts, the relative burden of financial risk, financial commitment and water resource management. The details of the Member Agency Managers' Proposal (Proposal) is included in **Attachment 1**.

The Subcommittee then reviewed staff's evaluation of the Proposal at the Subcommittee's September 18, 2001 meeting. On September 25, 2001, the Board held a Board Workshop on the Proposal. At that meeting, the Board considered a number of questions raised by the Subcommittee (see **Attachment 2**), as well as the Board, and directed staff to agendize the Proposal for Board action at the October 16, 2001, Board meeting.

The proposed rate structure is consistent with the Board's Strategic Plan Policy Principles, which were adopted in December 1999. The Proposal furthers Metropolitan's strategic objectives, supports and encourages sound water resource management, accommodates a water transfer market, enhances fiscal stability and is based on cost-of-service principles. An analysis of the Proposal and its consistency with the Board's Principles from December 1999 is shown in **Attachment 3**.

Summary of Proposal

<u>Tiered Rate Structure</u>. The Proposal retains the two-tiered pricing structure included in the Rate Structure Implementation Plan from December 2000. Such a pricing structure encourages efficient water resource management and conservation. The amount of water supply that a member agency may purchase in any one year at the lower Tier 1 rate is determined by two factors – the amount of firm water (basic and shift) purchased since fiscal year 1989/90 and the member agency's election to submit a voluntary purchase order for a ten-year supply of water.

A base level of consumption will be established for each member agency equal to the member agency's highest fiscal year firm demand since 1989/90. Member agencies will be able to submit a voluntary purchase order to purchase a minimum amount of water over the next ten years equal to 60 percent of this base times 10. The member agency has ten years to purchase this minimum quantity and can vary its purchase amounts from year to year. But, the member agency would be obligated to pay for the full purchase order, even if it did not use the full amount at the end of the ten-year period. In exchange for this minimum commitment, the member agency will be able to purchase an amount of water supply equal to ninety-percent of the base in any given year at the lower Tier 1 rate. Agencies that determined that a purchase order was not in their interest would be able to purchase up to 60 percent of their base at the lower Tier 1 rate.

Unbundled Rates and Charges. As described in the December Action Plan, rates and charges would be unbundled to reflect the different services provided by Metropolitan. Specifically, the following rate elements would be part of the Proposal:

a. **Tier 2 supply rate.** The Tier 2 Supply Rate would be charged on a dollar per acre-foot basis for system supply delivered in excess of 90 percent of a member agency's base for member agencies with purchase orders. The Tier 2 Supply Rate would be charged for system supply delivered in excess of 60 percent of a member agency's base for member agencies without purchase orders. The Tier 2 Supply Rate would be set at a level that reflects Metropolitan's cost of acquiring new supplies.

b. **Tier 1 supply rate.** The Tier 1 Supply Rate would be charged on a dollar per acre-foot basis for system supply delivered to meet firm demands that are less than 90 percent of a member agency's base for member agencies with purchase orders. The Tier 1 Supply Rate would be charged to system supply deliveries that are less than 60 percent of a member agency's base for member agencies without purchase orders. The Tier 1 Supply Rate would be set to recover all of Metropolitan's supply costs, except those paid through the Tier 2 Supply Rate and a portion of the long-term storage and agricultural water sales.

c. **System Access Rate.** The System Access Rate would be charged on a dollar per acre-foot basis and collect the costs associated with the conveyance and distribution system, including capital, operating and maintenance costs. The System Access Rate would be charged for every acre-foot of water conveyed by Metropolitan. All users (including member agencies and third-party wheeling entities) of the Metropolitan system would pay the same rate for conveyance).

d. **Water Stewardship Rate**. A Water Stewardship Rate would be charged on a dollar per acre-foot basis to collect revenues in support of Metropolitan's financial commitment to conservation, water recycling, groundwater recovery and other water management programs approved by the Board. The Water Stewardship Rate would be charged for every acre-foot of water conveyed by Metropolitan.

e. **System Power Rate**. The System Power Rate would be charged on a dollar per acre-foot basis to recover the cost of power necessary to pump water from the State Water Project and Colorado River through the conveyance and distribution system for Metropolitan's member agencies. The System Power Rate will be charged for all Metropolitan supplies. Entities wheeling water would continue to pay the actual cost of power to wheel water on the State Water Project, the Colorado River Aqueduct or the Metropolitan distribution system, whichever is applicable.

f. **Treatment Rate**. Metropolitan would continue to charge a treatment rate on a dollar per acre-foot basis for treated deliveries. The treatment rate would be set to recover the cost of providing treated water service, including capital and operating cost.

g. **Capacity Reservation Charge and Peaking Surcharge**. Member agencies would pay a Capacity Reservation Charge (set in dollars per cubic feet per second of the peak day capacity they reserved). The Capacity Reservation Charge is a fixed charge levied on an amount of capacity reserved by the member agency. The Capacity Reservation Charge recovers the cost of providing peak capacity within the distribution system. Peak-day deliveries in excess of the reserved amount of capacity chosen by the member agency would be assessed a Peaking Surcharge. Peaking Surcharge revenue collected by Metropolitan for the three fiscal years ending on June 30, 2005, would be refunded to that member agency to implement specific capital projects and programs to avoid peaking charges in the future. The Capacity Reservation Charge and Peaking Surcharge are designed to encourage member agencies to continue to shift monthly demands into the winter months and avoid placing large daily peaks on the Metropolitan system. Daily flow measured between May 1 and September 30 for purposes of billing the Capacity Reservation Charge and Peaking Surcharge will include all deliveries made by Metropolitan to a member agency or member agency customer including water transfers and agricultural deliveries.

h. **Readiness-to-Serve Charge**. Metropolitan's Readiness-to-Serve Charge would recover costs associated with standby and peak conveyance capacity and system emergency storage capacity. The Readiness-to-Serve Charge would be allocated among the member agencies on the basis of each agency's ten-year rolling average of firm demands (including water transfers wheeled through system capacity). This allocation would be revised each year. At the request of the member agency, revenues equal to the amount of Standby Charges would continue to be credited against the member agency's Readiness-to-Serve Charge obligation.

i. **Long-term storage service program.** The current long-term storage service program used by the member agencies for storage replenishment purposes would continue as is. The long-term storage rate would also remain a bundled rate. The long-term rate would be reviewed annually by the Board as part of the regular rate cycle. Although the Proposal recommends that the long-term storage service program remain in place for at least the next ten years, the Board retains the ability to reexamine this program as needed.

j. **Agricultural water program.** The current surplus water agricultural service program used by the member agencies for agricultural purposes would remain in place. The agricultural rate would also remain a bundled rate. The agricultural rate will be reviewed annually by the Board as part of the regular rate cycle. Although the Proposal recommends that the current agricultural program remain in place for at least the next ten years, the Board retains the ability to reexamine this program as needed.

Addressing New Demands. The Proposal addresses the impact of new demands on the cost of water supply through the tiered rate structure. Agencies that have increasing demands on Metropolitan would pay more, since they would purchase a greater share of the water sold at the higher Tier 2 rate. In addition, the Proposal provides that a mechanism to recover costs for Metropolitan's infrastructure associated with increasing system demands will be developed and in place by 2006.

Financial Impact

Financial Impact to Member Agencies. While the Proposal includes a number of changes to Metropolitan's existing structure, the initial financial impacts as a result of the change are estimated to be less than three percent (plus or minus), on any one member agency when compared to the existing rate structure. These impacts are estimated in fiscal year 2002/03 and assume normal demand conditions. Over time, it is expected that agencies using more Metropolitan supplies will purchase a greater share of water at the higher Tier 2 rate and would pay more.

Financial Impact to Metropolitan. The total amount of revenue generated under the Proposal would be the same as that under the proposed structure. The introduction of the purchase order helps to provide additional certainty regarding Metropolitan's base supply. But, the purchase order is flexible enough that member agencies do not take on undue financial risk. In addition, the Capacity Reservation Charge adds to fixed revenues.

Impact on Water Transfers. The Proposal provides clear price signals that reflect Metropolitan's costs (both to develop new supplies and to transport water). As such, cost-effective water transfers by Metropolitan and others would be facilitated by this rate structure.

Implementation Plan

If the Board approves the Proposal, a report would be prepared describing each of the above rate design elements in detail, including the cost of service used to develop the rates and charges. The Chief Executive Officer would recommend the rates and charges to the Board in January of 2002. A public hearing on the rates and charges implementing the Proposal would be held at the February 2002 Board meeting. The Board would take action to adopt the rates and charges in March of 2002. The rates and charges as described in the report and recommended by the Chief Executive Officer would be effective January 1, 2003. A Resolution to Adopt the Rate Structure Proposal is provided as **Attachment 4**.

Policy

The Proposal is consistent with the Board's Strategic Plan Policy Principles and addresses concerns raised by the Board regarding the December 2000 Rate Structure Action Plan.

CEQA

The proposed action, i.e., approval of the Proposal, is not defined as a project under the California Environmental Quality Act (CEQA), because it involves continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed action is not subject to CEQA because it involves the creation of government funding mechanisms or other government fiscal activities, which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment (Section 15378(b)(4) of the State CEQA Guidelines).

The CEQA determination is: Determine that the proposed action is not subject to CEQA per Sections 15378(b)(2) and 15378(b)(4) of the State CEQA Guidelines.

Board Options/Fiscal Impacts

Option #1

Adopt the CEQA determination and Resolution approving the Proposal and direct staff to take the necessary steps to implement rates and charges as defined by the Proposal to be effective January 1, 2003.
Fiscal Impact: Increased fixed revenue and financial commitment from member agencies. Total amount of revenue recovered from the member agencies will be the same.

Option #2

Defer consideration of the Proposal until further discussion by the Board.
Fiscal Impact: None

Staff Recommendation

Option #1

Brian G. Thomas *Chief Financial Officer*	10/9/2001 *Date*
Ronald R. Gastelum *Chief Executive Officer*	10/9/2001 *Date*

Attachment 1 - Member Agency Managers' Proposal MWD Rate Structure

Attachment 2 - Subcommittee on Rate Structure Implementation Responses to Subcommittee Questions

Attachment 3 - Comparison between Member Agency Managers' Rate Structure Proposal and Metropolitan's Board Principles

Attachment 4 - Resolution to Adopt Rate Structure Proposal

BLA #1374

MEMBER AGENCY MANAGERS' PROPOSAL
MWD RATE STRUCTURE
(PROPOSAL)

(AS SUBMITTED TO THE BOARD SEPTEMBER 25, 2001)

OVERVIEW

Objectives

The proposed rate structure is a pricing mechanism to achieve the following objectives:

- Maintain MWD as the regional provider of imported water – MWD, working collaboratively with its member agencies, will secure necessary water supplies and build appropriate infrastructure to meet current and future needs of its member agencies.

- Support cost-effective local resources development and water conservation – MWD will continue to help fund cost-effective water recycling, groundwater recovery, and water conservation.

- Accommodate a water market – By unbundling its water rate, MWD will accommodate a water market.

Proposed Rate Structure

In order to support MWD's strategic vision, member agencies have developed a rate structure proposal, which is consistent with MWD's Board's December 2000 action plan. This rate structure has the following components:

1. Unbundles water rate into five separate commodity rates: (1) supply; (2) system access, for conveyance and distribution; (3) water stewardship; (4) power; and (5) treatment.

2. Supply rate has two tiers.

3. Two fixed charges: (1) Readiness to Serve Charge (RTS), to help pay for emergency storage and standby for conveyance; and (2) Capacity Reservation Charge, to help pay for peaking for distribution.

4. Voluntary Purchase Order requests for firm water deliveries.

5. Surplus water, when available, for local long-term storage replenishment and agricultural deliveries.

Benefits of Rate Structure

The proposed rate structure offers the following benefits:

- ***Unbundled rates charge all users for system access on same basis.*** Separating supply costs enables MWD to treat everyone on equal basis (member agencies, retail providers, third parties), and is the first step in accommodating a water market.

- ***Tiered supply rates provides pricing signals for water users with increasing demands and incentives to maintain existing local supplies.*** Tiered water supply rates: (1) reflect higher costs of new MWD supply development; (2) signals users when local resources development and conservation might be more cost-effective; and (3) passes appropriate costs of new supply development to those member agencies that rely on MWD for growing demands.

- ***Voluntary Purchase Orders provide for commitment while protecting regional reliability to all.*** Purchase Orders are: (1) voluntary; (2) offer price incentives to member agencies by allowing more water deliveries to be purchased in lower-priced supply tier rate; (3) offer an additional level of financial commitment to MWD; and (4) are not tied to reliability (i.e., supply reliability for all member agencies is the same).

- ***Framework for future water management while avoiding significant cost impacts in the near term.*** The proposed rate structure offers a framework for future water management of imported and local water supplies without creating significant cost impacts to member agencies in the near-term.

<u>Implementation</u>

- The proposed rate structure will be implemented on January 1, 2003.

- The rate structure is a pricing mechanism designed to support a continued collaborative planning effort between MWD and member agencies used to determine MWD's future water supply and infrastructure needs.

DETAILS

General Overview

- Proposed rate structure is consistent with: (1) MWD Board Strategic Plan Policy Principles (adopted in December 1999); and (2) the intent and elements of MWD Board Action Plan for the rate structure (adopted in December 2000).

- Supply reliability is the same for all member agencies, i.e., not tied to contracts.

- Rates and charges unbundled, allowing for choice in services and providing the basis for a wheeling rate.

- Areas with increasing demands on MWD will pay proportionately more for their water through second tier of the water supply rate.

- Member agencies may request Purchase Orders for firm water supplies, offering pricing benefits for member agencies and more financial security for MWD.

Specific Elements

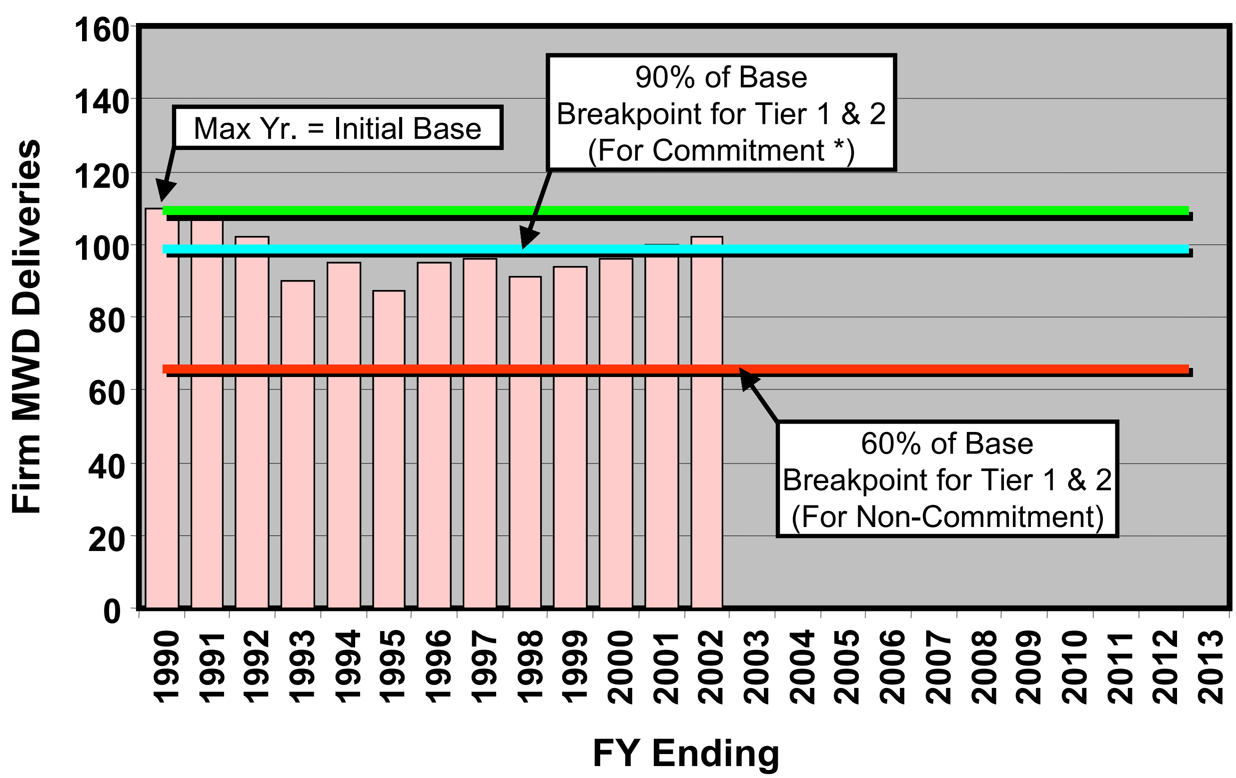
<u>Unbundled Commodity Rates</u>

A. Current commodity rate for water will be unbundled into five separate commodity rates:
   - Supply Rate – two tiers, and recovers costs associated with water supply (discussed in more detail in following section)
   - System Access Rate – recovers costs associated with system capacity for conveyance and distribution
   - Water Stewardship Rate – is used to help fund local water recycling, groundwater, and conservation programs
   - Power Rate – recovers MWD's melded power cost for pumping SWP and Colorado River supplies
   - Water Treatment Rate – recovers costs for treatment.

Water Supply Rate

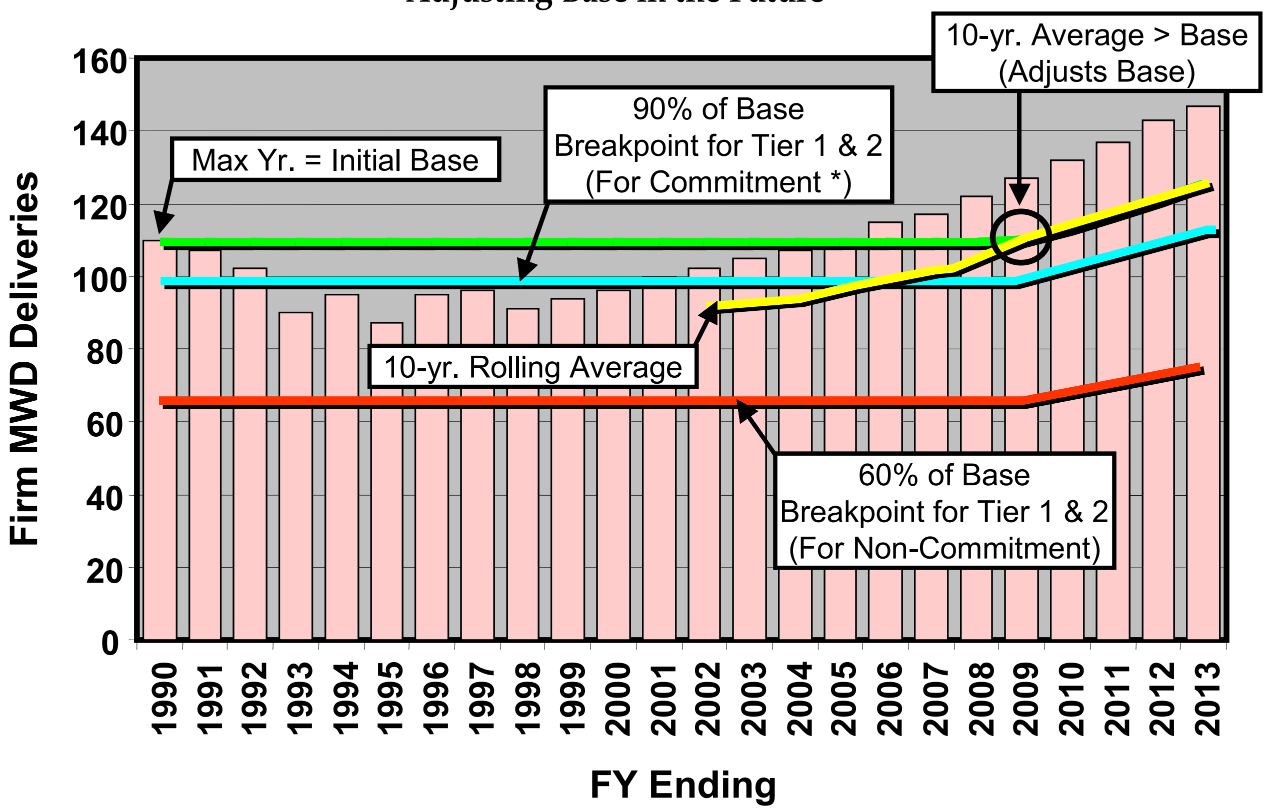
A. The water supply rate will have two tiers, which reflect MWD's existing and future costs for acquiring and storing supplies.
B. Tier 2 rate will be set by MWD's Board each year, to reflect MWD's incremental cost of providing water supply to its member agencies. Tier 1 rate will be set to recover remaining supply costs.
C. Tier 2 rate is currently estimated to be about $100 to $125/AF greater than the Tier 1 rate. Tier 2 rate will provide a pricing signal for local water management and water marketing.
D. A two-tier water supply rate will also address increasing demands placed on MWD.
E. An initial base (Base) for each member agency is established using that agency's highest firm water delivery from MWD from FY 1990 to FY 2002 (see Figure 1).
F. If a member agency chooses not to submit a Purchase Order request, then the Tier 1 rate would apply to firm water deliveries up to 60 percent of the Base, and the Tier 2 rate would apply to firm water deliveries above 60 percent of the Base, on an annual basis (see Figure 1).
G. If a member agency chooses to submit a Purchase Order request, then that agency agrees to purchase a minimum of 60 percent of its Base times 10, over the ten-year period.
H. Upon execution of the Purchase Order, the member agency is eligible to purchase up to 90 percent of its Base at the Tier 1 rate, and the Tier 2 rate would apply to firm deliveries above 90 percent of its Base, on an annual basis (see Figure 1).
I. In the future, the Base will be the greater of a member agency's historical maximum firm delivery from FY 1990 to FY 2002, or the ten year rolling average of firm deliveries (Figure 2).

Figure 1.
Two-Tiered Water Supply Rate:
Establishing the Initial Base



* Member agency agrees to purchase at least 60% of Initial Base times 10, over next ten years.

Figure 2.
Two-Tiered Water Supply Rate:
Adjusting Base in the Future



* Member agency agrees to purchase at least 60% of Initial Base times 10, over next ten years.

<u>Fixed Charges</u>

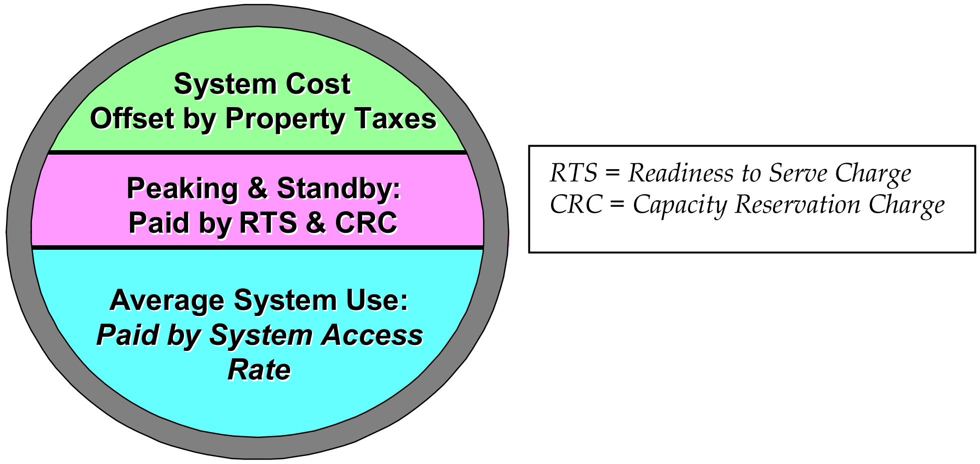
A. In addition to the commodity rates, member agencies would also pay the following fixed charges:
   - RTS Charge – covers costs for MWD's emergency storage and conveyance standby, which is allocated to each member agency based on its 10-year rolling average of firm demands
   - Capacity Reservation Charge – recovers costs for peak capacity on MWD's distribution system. Each member agency reserves summer (May through September) peak capacity and pays the charge based on capacity reserved on a cfs basis.

B. Standby charges, for those member agencies that elect to have MWD continue to assess the MWD Standby charge, will be deducted from member agencies' allocated RTS charges—as is currently done.

C. Property taxes will be used to offset capital costs for conveyance on the SWP and MWD's distribution system—as is currently done.

Figure 3 illustrates how the property taxes, fixed charges, and the System Access Rate will be used to recover costs for conveyance and distribution.

Figure 3.
MWD System Cost Allocation and Recovery



Local Storage Replenishment and Agricultural Deliveries

A. Surplus water supply, when available, can be purchased for long-term local storage replenishment and agricultural deliveries.
B. The current operating rules for surplus water purchases under the long-term seasonal storage and interim agricultural programs will continue.

Wheeling Services

Wheeling pays the following commodity charges:

- System Access Rate
- Water Stewardship Rate
- Power at actual (not melded) cost
- Water Treatment Rate (if necessary)
- Appropriate member agency costs

Implementation

This rate structure, with the elements described above, will be implemented on January 1, 2003. The rate structure is a pricing mechanism designed to support good water management and continued collaborative planning efforts between MWD and member agencies.

Addressing New Demands

A. The rate structure addresses the water supply portion of new demands on MWD, by including these costs in the Tier 2 Water Supply Rate.
B. MWD will utilize year 2005 Urban Water Management Plans from the member agencies and retail providers to identify MWD's new supply and infrastructure needs.
C. A mechanism to recover costs for MWD's infrastructure associated with increasing system demands will be developed and in place by 2006.

Subcommittee on Rate Structure Implementation
Responses to Subcommittee Questions

On September 18, 2001 staff presented the Member Agency Managers' rate structure proposal (Proposal) to the Subcommittee on Rate Structure Implementation (Subcommittee). The Subcommittee had several questions and asked staff, in consultation with the member agency managers, to respond prior to the September 25, 2001 Board workshop on the rate structure.

Question 1: What is the impact of reducing the maximum amount of Tier 1 water that a member agency with a purchase order can buy from 90 percent of its Base down to 80 percent of its Base?

Response: The 90 percent limit on supply purchases at the lower Tier 1 rate was chosen to minimize the initial financial impact and risk to all member agencies resulting from the Proposal and to encourage conservation and investments in local resources. If the limit on the amount of supply that can be purchased at the lower Tier 1 Supply Rate is reduced from 90 percent to 80 percent of a member agency's Base, more member agencies will immediately purchase a greater amount of their supply at the higher Tier 2 Supply Rate. This is particularly true during dry years when member agencies need more supply from the system. Lowering the amount of supply that can be purchased at the lower Tier 1 supply rate from 90 to 80 percent of a member agency's Base will result in substantial impacts during dry years and higher degrees of volatility in the average rate paid by the member agencies. Figure 1 illustrates the difference in the total amount of supply sold at the higher Tier 2 Supply Rate if 80 rather than 90 percent is used to define the amount of supply sold at the lower Tier 1 Supply Rate. The increase in the number of member agencies that would purchase supply at the higher rate is shown in Figure 2.

Figure 1. Total Amount of Supply Purchased At Higher Tier 2 Rate

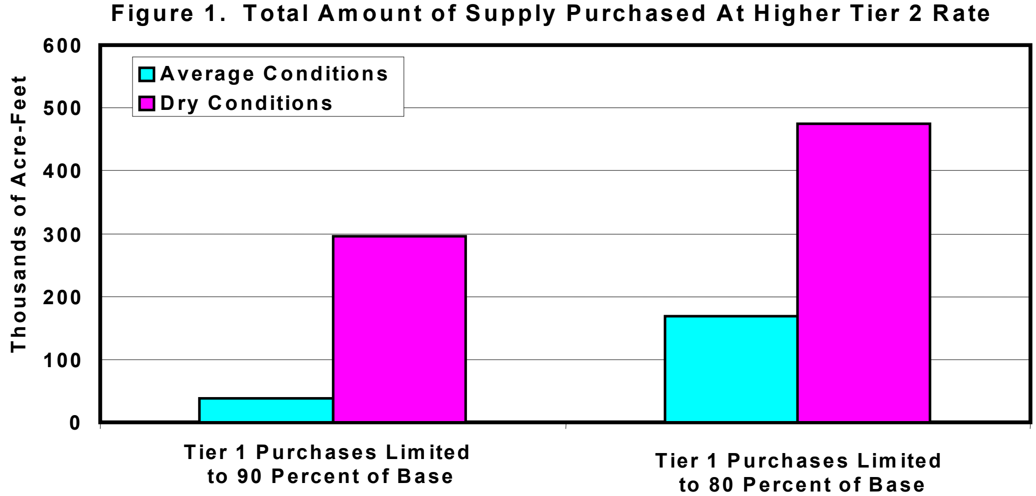
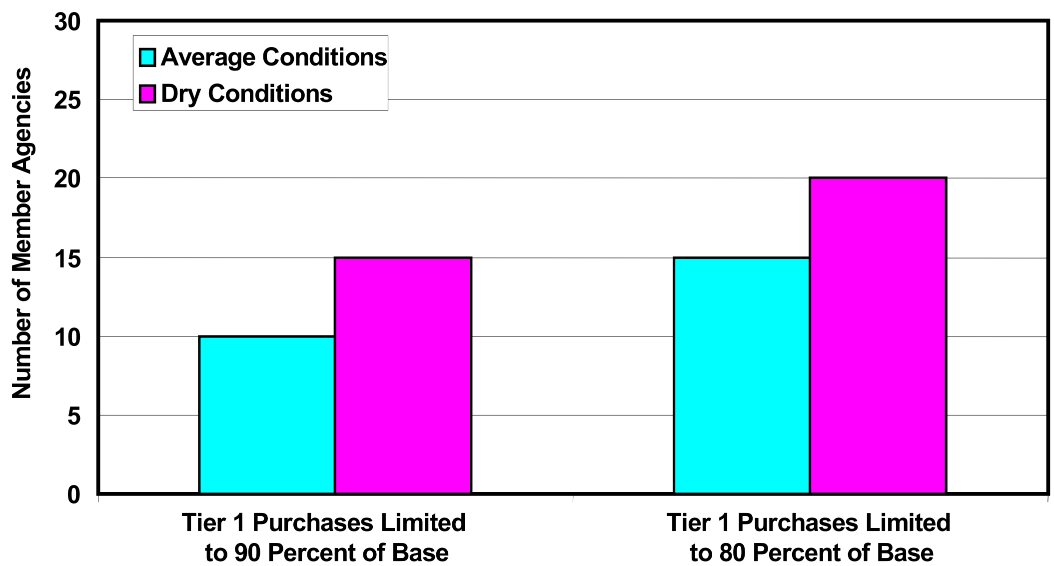


Figure 2. Number of Member Agencies that Purchase Supply At Higher Tier 2 Rate



Question 2: What is the impact of a cap on the differential between the Tier 1 and Tier 2 supply rates?

Response: The purpose of the Tier 2 Supply Rate is to reflect Metropolitan's cost of acquiring additional supply and encourage water conservation and investments in local resources. A cap on the differential between the Tier 1 and Tier 2 Supply Rates may result in a cap on the Tier 2 Supply Rate and potentially distort the price signal and its desired outcomes. However, each year as part of the annual rate setting process, the Board will review the supply conditions and the cost to set the Tier 1 and Tier 2 Supply Rates.

Question 3: Assuming that surplus water is available, how long will the current Long-term Seasonal Storage Service Program and Interim Agricultural Water Program be continued?

Response: The Proposal retains these programs to mitigate the initial financial impacts to the member agencies and their customers due to the change in the Metropolitan rate structure. The Proposal contemplates these programs would remain in place for the next ten years. As is the case today, the Board would set the rates for the Long-term Storage Service Program and Interim Agricultural Water Program.

Question 4: If a member agency increases its use of local supplies and decreases its use of Metropolitan system water, is its Base reduced?

Response: Under the Proposal, a member agency's Base would not be adjusted downward in order to avoid exposure to purchasing additional supplies at the higher rate. If the Base were adjusted downward member agencies that implemented conservation and more efficiently managed local resources would be penalized because they may have to purchase more water at the higher Tier 2 rate in the future.

Question 5: Does a member agency that unexpectedly loses local supply (e.g., groundwater contamination) have to pay the higher Tier 2 supply rate?

Response: A member agency that loses local supply production due to a system outage or a regulatory event may have to purchase supply at the higher Tier 2 rate. Over time, if the member agency is not able to reclaim its local supply and its use of Metropolitan supplies continues to increase, its Base will eventually increase as its ten-year rolling average of firm demand increases. As a result, the member agency would not continue to purchase more supply at the higher Tier 2 rate.

Question 6: How is the SDCWA/IID Transfer accounted for in the Base calculated for the San Diego County Water Authority?

Response: The initial Base used for purposes of determining the annual limit on Tier 1 purchases is defined as the maximum annual purchase since fiscal year 1990 and does not include the SDCWA/IID transfer. Under the Proposal, the calculation of the ten-year rolling average used to reset the Base in the future does not include the SDCWA/IID Transfer because the supply cost for this water would be paid by SDCWA. The SDCWA/IID Transfer is expected to begin in fiscal year 2003 at 20,000 acre-feet and increase by 20,000 acre-feet per year until reaching 200,000 acre-feet in 2012.

Question 7: Should there be a discounted rate (similar to the long-term replenishment rate) for deliveries used for seawater barrier purposes?

Response: Deliveries used for seawater barrier purposes cannot be interrupted during a drought or for any other reason. Metropolitan charges the full service rate for seawater barrier deliveries. Under the Proposal this practice would continue.

Question 8: If a member agency that has used less than its purchase order commitment requests more water from Metropolitan in the final year of the purchase order that Metropolitan cannot supply, is the member agency still obligated to pay for the entire purchase order commitment?

Response: The member agencies are obligated to pay for the entire purchase order commitment.

Question 9: What happens if not all of the supply available to the member agencies at the lower Tier 1 supply rate is purchased in a single year?

Response: The purchase order is a pricing tool only. If all of the supply that may be purchased at the lower Tier 1 rate is not used in a given year then that supply may be sold at the higher Tier 2 supply rate, available as surplus, stored for future use, or lost from the system.

Question 10: Can member agencies pool their purchase orders together or sell their purchase order to another member agency that wants to avoid the higher Tier 2 supply rate?

Response: The purchase order is a pricing tool. It does not confer a contractual right to system supply to a member agency. The Proposal does not accommodate the exchange or sale of purchase order quantities between member agencies.

Question 11: Can a member agency enter into a purchase order at any time?

Response: Under the Proposal, all member agency purchase orders would extend over the same ten-year period. Member agencies would execute purchase orders so that they would be effective January 1, 2003.

Question 12: What are the rules and formulas used to calculate the rates and charges?

Response: In January 2002, as part of the annual rate cycle and prior to adopting any rates and charges associated with the Proposal, the Board will receive a report on the Proposal. The report will include a detailed cost of service study, which will discuss the cost of service process.

An industry standard embedded cost of service process has been used to identify Metropolitan's revenue requirements by the various service functions (e.g. supply, conveyance, distribution, etc.) and to determine how much cost should be classified as being for peak, average and standby purposes. The classified service function costs are then allocated to the rate design elements. The following provides a brief description of each of the rate design elements.

- *Tier 2 Supply Rate ($/af)* - cost of acquiring additional supply.
- *Tier 1 Supply Rate ($/af)*- total supply revenue requirement less Tier 2 supply rate revenues and other revenue offsets, divided by projected Tier 1 deliveries.
- *System Access Rate ($/af)* - capital costs incurred to meet average demands and operations maintenance and overhead costs for the conveyance and distribution service functions divided by projected total deliveries.
- *System Power Rate ($/af)* - power costs for pumping on the State Water Project and Colorado River Aqueduct divided by the projected Metropolitan deliveries in acre-feet.
- *Water Stewardship Rate ($/af)* - Local Resources Program and Conservation Credits Program costs as well as other water management costs as determined by the Board divided by projected total deliveries.
- *Treatment Rate ($/af)* - cost of providing treated water service divided by projected treated water deliveries.
- *Readiness-to-Serve Charge (RTS)* - system emergency storage and conveyance and distribution standby costs not paid by property taxes. The RTS is allocated among the member agencies based on a ten-year rolling average of firm demands.
- *Capacity Reservation Charge (CRC) ($/cfs)*- distribution capital costs incurred to meet peak day demands divided by the total amount of capacity requested by the member agencies in cubic feet per second (cfs).

Question 13: Can Metropolitan implement the alternative rate structure in July of 2002?

Response: At the request of many of its member agencies, Metropolitan's rates currently become effective in January of each year. The January effective date provides enough time for the member agencies and their customers that typically budget on a July - June fiscal year basis to set their own rates and charges and prepare their own budgets. Even though the new rates and charges in the Proposal would not be effective until January of 2003, consistent with Metropolitan's current rate cycle, the Board would consider the new rates and charges recommended by the Chief Executive Officer in January of 2002, hold a public hearing on these rates and charges in February and then adopt the rates and charges in March of 2002.

A January effective date provides sufficient time for the member agencies and their customers to deal with implementation issues, including how to pass the Tier 1 and Tier 2 pricing on to their customers.

Comparison Between Member Agency Managers Rate Structure Proposal and Metropolitan's Board Principles (Prepared by Metropolitan Staff)

Board Principles	Member Agency Managers Rate Structure Alternative
Strategic Plan Policy Principles (Adopted in December 1999)	
Regional Provider Metropolitan is a regional provider of water for its service area. In this capacity, Metropolitan is the steward of regional infrastructure and the regional planner responsible for drought management and the coordination of supply and facility investments. Regional water services should be provided to meet the needs of the member agencies. Accordingly, the equitable allocation of water supplies during droughts will be based on water needs and adhere to the principles established by the Water Surplus and Drought Management Plan.	**Supports the Regional Provider Principle** • Metropolitan, working collaboratively with its member agencies, will secure necessary water supplies and build appropriate infrastructure to meet existing and future needs of its member agencies. • There would be no difference in reliability for firm supplies purchased at Tier 1 and Tier 2 rates.
Financial Integrity The Metropolitan Water District Board will take all necessary steps to assure the financial integrity of the agency in all aspects of operations.	**Supports the Financial Integrity Principle** • Through voluntary purchase orders, Metropolitan could have an assured level of firm water purchases up to 1.2 mafy (60% of maximum annual firm water sales) over ten years. • Through voluntary purchase orders, Metropolitan provides a pricing incentive for member agencies to purchase up to 1.7 mafy of firm water in 2003 (90% of maximum annual firm water sales). Compared to the current rate structure, fixed revenue is estimated to increase.
Local Resources Development Metropolitan supports local resources development in partnership with its member agencies and by providing its member agencies with financial incentives for conservation and local projects.	**Supports the Local Resources Development Principle** • Financial incentives for conservation and local projects are provided in two ways: (1) Tier 2 price is set at Metropolitan's cost of securing new supply and sends a price signal for alternative supply development and (2) water stewardship charge is established to help fund existing and future local water recycling, groundwater, desalination, and conservation programs.

Comparison Between Member Agency Managers Rate Structure Proposal and Metropolitan's Board Principles (Prepared by Metropolitan Staff)

Board Principles	Member Agency Managers Rate Structure Alternative
Strategic Plan Policy Principles - Continued	
Imported Water Service Metropolitan is responsible for providing the region with imported water, meeting the committed demands of its member agencies.	**Clarifies the Imported Water Service Principle** • Based on collaborative planning with member agencies, Metropolitan would secure and deliver imported water to meet existing and future supply needs.
Choice and Competition Beyond the committed demands, the member agencies may choose the most cost-effective additional supplies from either Metropolitan, local resources development and/or market transfers. These additional supplies can be developed through a collaborative process between Metropolitan and the member agencies, effectively balancing local, imported, and market opportunities with affordability.	**Supports the Choice and Competition Principle** • Member agencies may choose the most cost-effective additional supplies from among Metropolitan, local resources development and/or market transfers. In addition, the unbundling of rates and charges allows choice in services.
Responsibility for Water Quality Metropolitan is responsible for advocating source water quality and implementing in-basin water quality for imported supplies provided by Metropolitan to assure full compliance with existing and future primary drinking water standards and to meet the water quality requirements for water recycling and groundwater replenishment.	**Supports the Water Quality Principle** • Metropolitan's responsibilities for source quality and in-basin water quality for imported supplies are unchanged. The cost of source quality is recovered through the tiered supply rates. The cost for in-basin water quality is recovered through the treatment surcharge, which is the same as status quo.

Comparison Between Member Agency Managers Rate Structure Proposal and Metropolitan's Board Principles (Prepared by Metropolitan Staff)

Board Principles	Member Agency Managers Rate Structure Alternative
Cost Allocation and Rate Structure The fair allocation of costs and financial commitments for Metropolitan's current and future investments in supplies and infrastructure may not be reflected in status quo conditions and will be addressed in a revised rate structure: (a) The committed demand, met by Metropolitan's imported supply and local resources program, has yet to be determined. (b) The framework for a revised rate structure will be established to address allocation of costs, financial commitment, unbundling of services, and fair compensation for services including wheeling, peaking, growth, and others.	**Supports the Cost Allocation and Rate Structure Principle** • Committed demand by member agencies is established by voluntary purchase orders. • The allocation of cost and unbundling of services are based on standard cost-of-service methodology. • The existing full service rate is unbundled into: ➢ Tiered supply rates (reflecting Metropolitan's existing and future costs of supplies), ➢ System access rate (wheeling), ➢ Capacity reservation charge (peaking), ➢ RTS (standby), ➢ Water stewardship rate (local resources management), ➢ System power rate, and ➢ Treatment surcharge.
Steering Committee Guidelines (Approved in January 2000)	
"Needs-Based" Allocation • Dry-year allocation should be based on need	**Supports the guideline** • There would be no difference in reliability for firm supplies purchased at Tier 1 and Tier 2 rates.

Comparison Between Member Agency Managers Rate Structure Proposal and Metropolitan's Board Principles (Prepared by Metropolitan Staff)

Board Principles	Member Agency Managers Rate Structure Alternative
No Significant Disadvantage and Fair • Rate structure should not place any class of people in the position of significant disadvantage. • Rate Structure should be fair.	**Supports the guidelines** • Member agencies are treated equally. • All supplies would be allocated during droughts based on the water needs of member agencies. • Financial impacts to the member agencies in year 2003 are estimated to be minimal. The financial impacts henceforth are dependent on the collaborative planning between Metropolitan and member agencies and the ability of member agencies to develop cost-effective alternative supplies and manage peak deliveries.
Simple • Rate structure should be reasonably simple and easy to understand.	**Meets the guideline** • The proposal is easy to understand and is based on uniform rates and charges that recover costs of services.
Metropolitan Revenue Stability • Rate structure should be based on stability of Metropolitan's revenue and coverage of costs.	**Supports the guideline** • Compared to status quo, fixed revenue is estimated to increase by 50%. Fixed revenues are collected through property taxes, voluntary purchase orders, capacity reservation charge, and readiness-to-serve charge.

THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

RESOLUTION ____

RESOLUTION OF THE BOARD OF DIRECTORS OF THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA TO APPROVE RATE STRUCTURE PROPOSAL AND TO DIRECT FURTHER ACTIONS IN CONNECTION THEREWITH

WHEREAS, the Board of Directors ("Board") of The Metropolitan Water District of Southern California ("Metropolitan"), pursuant to Sections 133 and 134 of the Metropolitan Water District Act (the "Act"), is authorized to fix such rate or rates for water as will result in revenue which, together with revenue from any water stand-by or availability service charge or assessment, will pay the operating expenses of Metropolitan, provide for repairs and maintenance, provide for payment of the purchase price or other charges for property or services or other rights acquired by Metropolitan, and provide for the payment of the interest and principal of its bonded debt; and

WHEREAS, in July 1998 the Board commenced a strategic planning process to review the management of its assets, revenues and costs in order to determine whether it could conduct its business in a more efficient manner to better serve residents within its service area; and

WHEREAS, after conducting interviews with its directors, member agencies, business and community leaders, legislators and other interested stakeholders, and having public meetings to solicit public input, the Board developed and adopted Strategic Plan Policy Principles on December 14, 1999 (the "Strategic Plan Policy Principles" which document is on file with the Board Secretary) to guide staff and the member agencies in developing a revised rate structure; and

WHEREAS, the Board has received and reviewed several rate structure proposals developed during the strategic planning process and after thorough deliberation adopted a Composite Rate Structure Framework on April 11, 2000 (the "Rate Structure Framework" which document is on file with the Board Secretary); and

WHEREAS, the Board adopted a Rate Structure Action Plan on December 12, 2000 (the "Action Plan" which document is on file with the Board Secretary) and endorsed in concept a detailed rate design proposal (the "December 2000 Proposal" which document is on file with the Board Secretary) developed from the Rate Structure Framework and directed staff to work with the Board and member agencies to resolve outstanding issues identified during the implementation of this rate design; and

WHEREAS, on September 10, 2001 an alternative Rate Structure Proposal was originally presented to the Board's Subcommittee on Rate Structure Implementation (the "Subcommittee") for its review and consideration; and

WHEREAS, on September 18, 2001 the Subcommittee evaluated and considered the alternative Rate Structure Proposal (see Attachment 1 to Board Letter 9-6, dated the date hereof and hereinafter referred to as the "Proposal"), together with staff analysis of the Proposal and other information and comments received from member agencies; and

WHEREAS, on September 25, 2001, the Proposal, together with a staff review thereof, was further discussed and considered by the Board of Directors; and

WHEREAS, each of said meetings of the Board were conducted in accordance with the Brown Act (commencing at 54950 of the Government Code), at which due notice was provided and quorums were present and acting throughout; and

WHEREAS, the Proposal is consistent with the Board's Strategic Plan Policy Principles, supports efficient water resources management, encourages water conservation and facilitates a water transfer market;

NOW, THEREFORE, the Board of Directors of The Metropolitan Water District of Southern California does hereby resolve, determine and order as follows:

1. The Board finds that the Proposal is consistent with the Board's Strategic Plan Policy Principles, addresses the issues raised during the consideration of the December 2000 Proposal, furthers Metropolitan's strategic objectives to ensure the region's long term water supply reliability, supports and encourages sound and efficient water resources management, supports and encourages water conservation, facilitates a water transfer market and enhances the fiscal stability of Metropolitan.

2. The Board hereby directs the Chief Executive Officer, in consultation with the General Counsel, to take all actions necessary in order to further implement the Proposal in accordance with the terms set forth in this Resolution.

3. The Board approves the Proposal and directs the Chief Executive Officer, in consultation with the General Counsel, to (i) prepare a report on the Proposal describing each of the rates and charges and the supporting cost of service process and (ii) utilize the Proposal as the basis for determining Metropolitan's revenue requirements and recommending rates to become effective January 1, 2003, in Metropolitan's annual rate-setting procedure pursuant to Section 4304 of the Administrative Code. Under the procedure set forth under Section 4304, a public hearing on the rates and charges implementing the Proposal shall be held at the February

2002 Board meeting (or such other date as the Board shall determine) and the Board will take final action to adopt the rates and charges in March of 2002 (or such other date as the Board shall determine).

4. The Chief Executive Officer, the Chief Financial Officer and the General Counsel are hereby authorized to do all things necessary and desirable to accomplish the purposes of this Resolution, including, without limitation, the commencement or defense of litigation.

5. This Board finds that approval of the Proposal as provided in this Resolution is not defined as a Project under the California Environmental Quality Act (CEQA), because the proposed action involves the creation of government funding mechanisms or other government fiscal activities which do not involve commitment to any specific project which may result in a potentially significant physical impact on the environment (Section 15378(b)(4) of the CEQA Guidelines).

6. If any provision of this is held invalid, that invalidity shall not affect other provisions of this Resolution which can be given effect without the invalid portion or application, and to that end the provisions of this Resolution are severable.

I HEREBY CERTIFY, that the foregoing is a full, true and correct copy of a Resolution adopted by the Board of Directors of The Metropolitan Water District of Southern California, at its meeting held on October 16, 2001.

____

Executive Secretary
The Metropolitan Water District
of Southern California

San Diego County Water Authority
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October 13, 2014

Randy Record
and members of the Board
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

RE: Finance and Insurance Committee Item 6c – Update on Purchase Orders

Dear Chairman Record and Board Members,

We have reviewed Finance and Insurance Committee (Committee) Item 6c RE Update on Purchase Orders and have a number of questions and comments we would like to ask and discuss with our fellow board members. At last month's Committee meeting, the General Manager suggested we might schedule a special Board workshop to talk about these issues, and we hope that will happen and request that such a workshop be scheduled as soon as possible.

A number of directors observed at the last Committee meeting that a short-term extension of Purchase Orders does nothing to achieve the stated purpose of bringing stability to MWD's finances. Our Chief Financial Officer has stated as much – that the terms of the existing Purchase Order have failed to achieve that objective. However, rather than abandoning that important objective – like the most recent staff proposal does, as described in the PowerPoint Presentation – we would like staff to bring back new terms that *could* achieve that objective.

At last month's Committee meeting, a number of directors also observed that this issue has to do with rates, and how MWD's capital costs and operating expenses will be paid. We agree; that's why we also believe that the Purchase Order must be based upon, and reflect MWD's costs of service. While that has not been so in the past (including but not limited to issues that were presented at the trial of the rate case), it is *certainly* not the case when member agencies are allowed to "choose" what rate to pay without regard to the costs they are causing MWD to incur. The staff presentation at the last Committee meeting showed the extent of Tier 2 rates that have been paid over the 10-year period 2003-2013; the newly proposed Purchase Order would allow these agencies (which include a significant share paid by the Water Authority, although it was not listed by name) to "choose" to pay a lower rate.

During the trial of the rate case, MWD and its counsel stated many times that Tier 2 pricing is intended to recover dry-year peaking costs. Now, with no explanation or analysis, staff is recommending that agencies be allowed to "choose" whether and when to pay these costs. At a minimum, the Board would benefit from a review of MWD's current cost of service report to explain: 1) how dry-year peaking costs are accounted for; and 2) why eliminating the annual Tier 2 rate assessment is consistent with MWD's own cost of service analysis. MWD must first determine the availability and cost of its various supply sources and capital costs, and then set tiers and rates based on cost of service requirements of the law (including Prop. 26) and industry standards.

Based on the information provided, MWD has demonstrated a need to have Tier 2 rates with a *lower* threshold, rather than a higher threshold because: 1) its State Water Project supplies are unreliable, resulting in the need for spot water transfers, water banks, surface storage, and Bay Delta Conservation Plan; 2) its Colorado River supplies need to be shored up through water transfers, agricultural conservation and fallowing, and other programs; and 3) member agencies have different annual use and dry-year peaking patterns that must be accounted for.

If MWD would institute Tier 1 and Tier 2 pricing based on the quantities of reliable supplies it has available, and its additional expenditures to secure additional supplies or enhance the reliability of its firm supply, the price differential would provide member agencies incentive (along with 20 by 2020 requirements) to develop local supplies and increase conservation – without the need for MWD to increase its own water rates to pay subsidies to "incentivize" them to do so. This would reduce overall MWD costs. There are a number of mechanisms by which allocation of Tier 1 quantities among agencies could be made, including preferential rights.

We look forward to working with you and to continued discussion of these important issues.

Sincerely,

Michael T. Hogan Keith Lewinger Fern Steiner

Michael T. Hogan	Keith Lewinger	Fern Steiner
Director	Director	Director

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May 12, 2014

Jeffrey Kightlinger 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 8-2: Authorize execution and distribution of the Official Statement in connection with the issuance of the Special Variable Rate Water Revenue Refunding Bonds, 2014 Series D, and authorize payment of costs of issuance from bond proceeds - **OPPOSE**

Mr. Kightlinger and Members of the Board:

The Water Authority's MWD Delegates have reviewed the May 13, 2014 Board Memo 8-2, including the redline copy of Appendix A and have determined we must again vote against the staff recommendation to authorize the execution and distribution of the Official Statement in connection with the sale of bonds. We request that staff and bond counsel respond to each of the issues and questions presented in this letter and past letters, which are incorporated by reference. Additional copies are available upon request.

General Comments

The INTRODUCTION (page A-1) has added a sentence that states that, "...statements [in Appendix A] are based on facts and assumptions set forth in Metropolitan's current planning documents, including, without limitation, its most recent biennial budget." We believe that this statement fails to adequately disclose that MWD's "long term" planning process is now effectively *limited* to the two-year planning horizon of the biennial budget. We believe that full disclosure of the relevant facts and circumstances would include, not only reporting that the Long Range Finance Plan has not been updated for more than ten years (since 2004), but that material changes have occurred during that time period. Further, that the member agencies have been *unable to agree on a long term finance plan to pay for MWD projects and programs.* We also believe that MWD should disclose its recent shift from forecasting *actual* projected revenues and expenses (to use MWD's new terminology, changed in this Appendix A), to the use of "average" sales assumptions," which staff has set at a number where sales are expected to be exceeded in seven out of ten years. Such an artificial approach to "budgeting" -- is not "conservative," as it has been described by staff, it is a flagrant attempt to obviate the requirement to meet cost-of-service requirements in the setting of MWD's rates and charges. MWD simply wants to use massive over-collections -- as it has over the past two years -- any way it wants without having to explain to ratepayers in advance how much money it needs to provide the services it provides, i.e., have a real budgeting process.

Please explain the substantive change intended, if any, in the terminology edits of "expenditures" to "expenses" and "receipts" to "revenues" throughout this Appendix A.

Comments on Draft Appendix A

A-4: Drought Response Actions. MWD lacks a comprehensive board policy guiding the use and replenishment of storage reserves to meet dry-year demands. While MWD may have sufficient water in storage to meet full demands this year, the use of more than 1 million acre-feet – or, almost one half -- of MWD's reserves in one year as currently planned poses a great risk to MWD's water supply reliability next year and in future years, should the drought continue. Appendix A should disclose that risk and MWD's plan to mitigate the risk and related impacts to MWD's revenues and finances. MWD should also disclose where it expects to secure supplemental water transfers and purchases to meet regional demands under current conditions.

A-4: Financial Reserve Policy. MWD's financial reserve policy for many years was to cap reserves to ensure MWD did not retain more cash than it needs from its ratepayers – as evidenced by the use of the word, "maximum level" of reserves in all previous Appendix A Official Statements. Recently, staff self-declared that the policy was not a "cap" at all, but a "target," all without a single board meeting or directive to change the policy.

The discussion of *MWD's financial reserve policy* at page A-4 also creates the appearance that MWD has "planned" to manage under and over collections through its "financial reserve policy." Nothing could be further from the truth. MWD's revenue and expense projections have historically been off by hundreds of millions of dollars -- over or under. This is not the result of "drought," "climate change" any other unforeseen circumstance or financial management through MWD's "reserve" policy; it is simply the result of poor planning and estimation by MWD, and the improper use of reserves for expenditures other than maintaining stable and predictable water rates and charges. As noted above, MWD has recently changed its "budget" and rate-setting process to use sales and revenue estimates that staff *knows* will be exceeded in seven out of ten years. MWD has chosen to set budget and rates arbitrarily, rather than best-estimated sales and expense projections that are essential to sound business management and rate-setting. This shift and the risks of such an approach should be disclosed in Appendix A.

In order to avoid the consistent, materially incorrect shortcomings in its sales estimates used in rate setting, MWD should instead take into account its member agencies actual projected demand for MWD water, which factors in their reductions or increases in reliance on local water supplies. MWD's failure to do so presents a substantial risk of stranded costs and commensurate impact driving up water rates.

A-6 Recycled Water. The description of recycled water as “not potable” is dated and should be modified. Orange County Water District already is using recycled water to recharge its groundwater basin. With today’s technology, recycled water can be treated to potable water quality.

A-21 Sale of Water by the Imperial Irrigation District to San Diego County Water Authority. The Water Authority has objected on many past occasions to the language describing the sale of water by IID to SDCWA and transportation of that water by MWD as the payment by the Water Authority of "a lower rate" for the MWD water. This language is designed solely to support MWD's litigation arguments, and does not accurately describe the facts or terms of the Exchange Agreement. The description is misleading in that it intends to suggest to the public that MWD's water sales are higher than they really are.

A-29 MWD water storage capacity and water in storage. The Table that describes MWD’s various storage accounts should also disclose MWD’s contractual obligations to deliver water out of storage. For example, on page A-26, the Appendix A described the arrangement MWD has with Southern Nevada Water Authority whereby MWD agrees to store unused Nevada’s Colorado River apportionment for SNWA’s later use. The Appendix A states that through 2013, MWD has stored 160,000 acre-feet of SNWA water, which it eventually will need to pay back. That information, and any other MWD obligations and limitations on available storage supplies, including take capacity, should be disclosed clearly on the table displayed on page A-29.

A-43 Capital Investment Plan. Please explain why "resource development" was deleted as an objective of the Capital Investment Plan (CIP). Also, how MWD has valued "flexibility" for purposes of rate-setting and allocation of CIP costs. These edits again appear to be litigation-driven rather than based on any facts or programmatic changes to or relative benefits of the CIP.

A-44 Pay-as-you-go funding. The Appendix A should disclose that the over-collected revenues were not the result of "improved financial operations," as stated, but rather, were the result of poorly estimated revenues and the intentional use of sales that exceed artificial estimates as described above. The Appendix A misleads the reader into believing that MWD's over-collected revenues are the result of improved financial operations, when nothing could be further from the truth. Further, the Appendix A states that, "[a]s in prior years, pay-as-you-go funding may be reduced or increased by the Board during the fiscal year," without mentioning that the board has had an established pay-as-you-go funding policy that it has failed to meet. Moreover, there has never been any board policy discussion on the merits of changing the $95 million cap to $160 million. MWD's lack of disclosure on financial projections and policies is arbitrary and inherently involves great risk, which should be disclosed in the Appendix A.

A-46 Distribution system - prestressed concrete cylinder pipe. Please provide a copy of the estimate to reline all 100 miles of PCCP at $2.6 billion.

A-46 Administrative Code. Please add a statement that the General Counsel has opined that the Administrative Code may be waived by the Board of Directors *ex post facto*, without prior notice and without even knowing that they are doing so. We are aware of no other public agency that has such an unusual procedural process, which we believe materially reduces the transparency and accountability of the MWD board of directors and limits the public's - and bond investor's - ability to be advised in advance and be heard on MWD board actions.

A-50 Property taxes. Please indicate that there is substantial disagreement regarding MWD's interpretation of what is "essential to the fiscal integrity of the district" and that there has been no cost-of-service study or report supporting the claim that the suspension of the tax limitation results in a "fair distribution of costs throughout MWD's service area," except for MWD's own bald assertion that is the case.

A-52 Water wheeling and exchanges as MWD "sales." MWD continues the highly misleading practice of reporting revenues from wheeling service as MWD water sales. Wheeling service should be reported separately from the sale of MWD water supplies. It is also highly misleading to investors to use "average" dollars per gallons per acre-foot of water sold because it impedes the ability of investors in MWD bonds to understand what alternative sources of supply are competitive with MWD water supplies and therefore may be expected to reduce MWD's future water sales.

A-53-55 Litigation Challenging Rate Structure. Although MWD characterized the Water Authority's rate cases as a challenge to MWD's "rate structure," the cases challenge the specific allocation of costs in the specific years at issue in each case. The description of the Court's ruling is incomplete in that it fails to mention that the Superior Court found that MWD's allocation of costs are ***not reasonable*** and violate the common law, California statutes and the California Constitution, including Proposition 26. The trial court has determined that MWD's rates violate all of these legal standards and requirements.

A-59, 60 Financial reserve policy. Please provide a copy of the probability studies of the wet periods that affect MWD's water sales. Please provide a 10-year summary of how successful the Water Rate Stabilization Fund has been in maintaining stable and predictable water rates and charges. MWD's financial reserve policies must be revised to comply with Proposition 26. MWD is essentially operating a giant slush fund without any cost-of-service basis for its rates and charges prior to or after collection of those rates and charges.

A-62 Ten largest water customers. It is misleading to characterize wheeling/exchange water as MWD "water sales" because there is no basis in law or fact for doing so.

A-62-63 California ballot initiatives. The Appendix A fails to disclose that the Superior Court has already ruled that Proposition 26 applies to MWD for all rate years subsequent to the time the ballot measure was passed in November 2010, i.e., MWD is subject to Proposition 26 going forward. MWD has not established rates and charges that comply with Proposition 26 and will have the burden in court in future years to prove that it has done so. This presents a substantial risk of ongoing and continued litigation unless and until MWD changes its cost-of-service and rate-setting practices.

A-81 BDCP costs. Please confirm what BDCP costs have been included on the Table at page 81.

A-84 Historical and projected revenues and expenses. MWD's projected revenues and expenses have been arbitrarily established. No member of the public or investor could know what MWD's projected revenues and expenses will be, given the arbitrary manner in which MWD has established its budget and rates as described above. Further, MWD has a poor record of projecting future rate increases; its rates have more than doubled over the past ten years, which is materially more than projected by MWD. Its future rate projections -- which include investments that may be made in the BDCP -- will supposedly result in rate increases lower not higher than in the past. This is not logical or based on any credible cost analysis or rate projections.

We incorporate by reference all of our prior comments in prior letters to MWD which have not been corrected in this or past versions of the Official Statement.

Sincerely,

Fern Steiner Director	Michael T. Hogan Director	Keith Lewinger Director	Vincent Mudd Director

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March 9, 2014

Randy Record 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 8-1: Approve and Authorize execution and distribution of Remarketing Statements in connection with the remarketing of the Water Revenue Refunding Bonds (Index Mode), 2011 Series A-2 and A-4 and 2012 Series B-1 and B-2

Chair Record and Board Members:

The Water Authority's MWD Delegates have reviewed the March 10, 2015 board memo 8-1, including the redline copy of Appendix A dated February 26, 2015, and determined we must vote against staff's recommendation to authorize the execution and distribution of the Official Statement and Remarketing Statements in connection with the refunding of bonds. While we support staff's general financial management objective, we do not believe that the bond disclosures fairly present current and projected water supply conditions, MWD's financial position or risk. We request that staff and bond counsel respond to each of the issues and questions presented in this letter.

General Comments

We attach and incorporate by reference our last letter to you dated November 17, 2014 ("November Letter"), to which no response has been received from MWD or its bond counsel. None of the major issues addressed in the General Comments section has been addressed, including but not limited to:

- Financial risk associated with the absence of a long range finance plan or any commitments by MWD's member agencies to pay for MWD's long-term water supply investments;
- Uncertainty created by the current MWD budget process, which is no longer based on actual projections or expenses, but instead, is based on arbitrary numbers which result in the systematic over-collection of revenues from MWD ratepayers (in the

hundreds of millions of dollars); and

- Continued violation of Proposition 26 and cost of service legal requirements due to the failure of MWD's accounting system to track revenues it receives from different sources.

A more complete discussion of these issues is included in our November Letter and in the Comments on Appendix A, below.

We do note and appreciate the edit that was made in the new draft Official Statement at page A-51, noting that MWD's statutory authority and voter authorization to levy *ad valorem* taxes to pay its outstanding general obligation bonds and to satisfy its State Water Project (SWP) obligations is *limited to the debt outstanding as of 1990-91*. We felt this omission from past versions of Appendix A was both material and misleading (see our November Letter at p. 3, RE paragraph A-49) and appreciate you adding this language in the current draft.

Comments on Draft Appendix A

A-3: Metropolitan's Water Supply and A-4: Drought Response Actions. The discussion in these and other sections of the draft Appendix A fails to accurately report the severity of MWD's current water supply conditions in the context of this fourth-consecutive drought year or for 2016 and beyond. See our March 6, 2015 letter to the MWD board RE: Water Planning and Stewardship Committee Agenda/Water Supply Management Strategies Including Use of Storage, incorporated herein by reference. Taken together with other sections of the draft Appendix A, in which water sales are projected for the next five years (see page A-83) but where the source or cost of the water to be sold is not identified, the draft Appendix A fails to present an accurate picture of MWD's water supply situation or financial risk.

A-7: State Water Project. We presume the final document will be corrected to reflect the recent action taken by the Department of Water Resources (DWR) to increase the SWP allocation to 20%. With regard to SWP supplies, we believe MWD should also disclose that it used all of its available DWR flex storage in 2014 (219,000 AF) and that those supplies not only will not be available in 2015, but must be paid back to DWR within five years. More broadly, MWD should make full disclosure in the draft Appendix A of *all* water supplies it has "borrowed" and which therefore include pay-back requirements that could affect the availability of supplies in future years. MWD should also disclose the unique service requirements associated with serving the "SWP-Exclusive Area;" this issue has not previously been addressed in MWD's Integrated Resources Plan (IRP).

A-16: Colorado River. The draft Appendix A should be revised to include a discussion about current Basin States' efforts to increase storage in Lake Mead and the US Bureau of Reclamation's analysis regarding the probability of shortages on the Colorado River beginning in 2016. These shortages, coupled with continued drought and severe limitations on SWP supplies present material water supply and financial challenges to MWD. MWD has borrowed 162,000 AF of water from the Southern Nevada Water Authority; as noted above, this and other water supply "debt" should be fully disclosed in the Appendix A. At page A-5, MWD added language that the CRA is anticipated to operate at capacity in 2015, *"assuming additional supplies are acquired."* MWD should identify how much water it needs to keep the CRA operating at capacity and the potential sources of water supplies to do so.

A-30: MWD's Water Storage Capacity and Water in Storage. The amount of water in storage shown does not match data presented in MWD's January 2015 WSDM report; please reconcile the differences. We also believe MWD should amend this presentation to clearly reflect how much water is available for dry-year use and how much is required for emergency storage (626,000 AF).

A-31: Water Conservation. This section of the draft Appendix A is misleading because MWD has not measured and its conservation programs to do not require any measurement of actual water conservation savings from MWD programs. There is no evidence to support the statement that the 2009-2012 water sales numbers reflect the "success" of MWD's water conservation programs.

A-32: Water Surplus and Drought Management Plan and Water Supply Allocation Plan. See concerns expressed at A-3, above. Regarding Preferential Rights, contrary to the statement in the draft Appendix A, these rights have been "used" in many ways over the years in allocating MWD's water. MWD itself has been clear that the MWD board does not have the authority to change rights MWD member agencies have under the MWD Act, including Preferential Rights. If MWD persists in making this misleading statement, it should at a minimum disclose as a recent example, that in October 2014, the Central Basin Municipal Water District asserted a claim to water based on Preferential Rights. The claim was only "rescinded" after MWD agreed to provide additional water supplies it had previously refused to deliver.

A-51: Metropolitan Revenues. See November Letter at p. 3, RE A-49: Metropolitan Revenues: General. Given the reality that many MWD member agencies are planning to reduce their purchases of MWD water, MWD should describe the role it anticipates tax revenues may play *or it believes must play* in the future in order to sustain MWD's fiscal integrity.
A-55: Litigation Challenging Rate Structure. MWD should disclose that the amount of damages awarded to the Water Authority may be determined by the Court in an amount that exceeds the amount that is held in the escrow account. Further, that the Court's April 24, 2014 Statement of Decision found that Proposition 26 applies to MWD to all rates set after the date of enactment of the measure. Finally, the draft should disclose that the May 2014 case has been stayed by stipulation of the parties.

A-57: Member Agency Purchase Orders. MWD should disclose that there is no cost of service basis for the terms described in MWD purchase orders. See also November Letter at p. 4, RE A-56: Member Agency Purchase Orders.

A-58: Classes of Water Service. See November Letter at p. 4, RE A-56: Classes of Water Service.

A-59: Additional Revenue Components. MWD is proposing an edit that is inconsistent with all past cost of service analyses by MWD, namely, to change the statement that the RTS charge is designed to recover "a" portion of capital expenditures for infrastructure projects needed to provide standby service and peak conveyance needs, to the statement that the charge is designed to recover "the" portion of capital expenditures made for those purposes. This is nothing more than *ex post facto* "sleight of hand" designed to shore up MWD's litigation posture. There is no cost of service analysis to support this change and the change is inconsistent with how MWD's cost of service was performed and with how its rates have been established. If MWD wants to make this change, it must do so as a matter of substance, with an accurate calculation of costs MWD incurs to provide standby service and peak conveyance needs. That is not what is captured by the current RTS charge and that is what the current cost of service report states, which is different than the "edit" MWD is proposing to make in the draft Appendix A.

A-60: Financial Reserve Policy. Proposition 26 applies to MWD; as a result, the MWD board does not have complete discretion *ex post facto* to determine how to spend over-collected revenues that are not based on any cost of service analysis. The planned over-collection of revenues and refusal to account for and track revenues by rate category subjects MWD to the further risk of litigation based on its unlawful practices.

A-62: Ten Largest Customers. See November Letter at p. 5, RE A-62.

A-63: California Ballot Initiatives. See November Letter at p. 5, RE A-63.

A-76: State Water Contract Obligations. As noted above and in numerous prior letters we have authored on a variety of subjects, the Water Authority believes it is highly misleading for MWD to substitute old estimates or arbitrary numbers for planning purposes when actual numbers (or at least more reasonable estimates based on currently known data) are available. No more clear illustration exists how this skews financial and water resource planning (and, in this context, how it misrepresents information to investors) than MWD's use of "budgeted" State Water Project costs. MWD chose to "budget" based on a 50% water supply allocation at the same time the actual allocation was 5%. In the draft Appendix A, MWD is still using its budget numbers to describe its projected costs for SWP water, even though the SWP allocation is actually 20% with very little if any expectation of change this year. This means that MWD is (mis)representing that it will incur costs to acquire SWP water that it knows it will not incur and sell SWP water that it knows it will not have to sell.

A-82: Historical and Projected Revenues and Expenses. Based on the available information, it is unreasonable to predict that MWD water sales will be as described at page A-83 unless the drought ends, MWD finds sources of water supply that it has thus far been able to identify or secure or MWD imposes deeper supply cuts. The description of forecasted MWD water sales should include a more robust analysis of water supplies remaining in storage and where MWD expects to secure the water it needs to meet these sales projections.

A-84: Operations Funded from Prior Year Revenues. Please identify 1) why operations are being funded by prior year revenues (and whether the same operations were also included in the current year's budget); 2) the source of revenues used to pay these operating costs; and 3) why operating costs would be paid from revenues deposited to the Water Management Fund.

A-87: Water Sales Projections. See discussion above, at A-82. Where will MWD secure the water supplies that water sales projections are based on?

We incorporate by reference all of our comments in prior letters to MWD that have not been corrected in this or past versions of the Official Statement, including but not limited to the comments in our November Letter.

Sincerely,

Michael T. Hogan	Keith Lewinger	Fern Steiner	Yen C. Tu
Director	Director	Director	Director

Attachments:

1. Water Authority Letter on MWD's Official Statement dated November 17, 2014

nu

cc: Jeff Kightlinger, General Manager
Dawn Chin, Office of the Board of Directors

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

November 17, 2014

Randy Record 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 8-2: Authorize the execution and distribution of (1) the official Statement in connection with the issuance of the Waterworks General Obligation Refunding Bonds, 2014 Series A; and (2) Remarketing Statements in connection with remarketing of the Water Revenue Refunding bonds (Index Mode), 2011 Series A-1 and A-3, and 2009 Series A-2 – **OPPOSE**

Dear Chair Record and Members of the Board:

The Water Authority's MWD Delegates have reviewed the November 18, 2014 board memo 8-2, including the redline copy of Appendix A, and have determined we must vote against staff's recommendation to authorize the execution and distribution of the Official Statement and Remarketing Statements in connection with the refunding of bonds. While we support staff's objective to refund debt in order to reduce MWD's financial obligations, we do not believe that the bond disclosures fairly present MWD's financial position or risk. We request that staff and bond counsel respond to each of the issues and questions presented in this letter.

General Comments

At the outset, we note that a number of comments we have provided in the past have not been substantively addressed by changes in the Official Statement; we do not repeat, but incorporate herein by reference all of the issues that have been raised in prior letters that have not been substantively addressed by MWD management.

We noted in our last comment letter that MWD had abandoned its effort to conduct a comprehensive update of its 2004 Long Range Finance Plan, now more than 10 years old. Rather than continue to work with the member agencies to determine their willingness to pay MWD's long-term capital and operating costs -- an effort that was unsuccessful after five years of on again/off again "rate refinement" meetings -- MWD chose to simply "declare" that the 10-year rate forecast in its biennial budget *is* its long-range financial plan. But the biennial budget contains no reference to how MWD will ensure a sustainable revenue source from its member agencies to support MWD's projects and programs in the long term. The draft Appendix A fails to disclose that MWD has not been successful in its efforts to develop long-term revenue commitments to pay for long-term water supply investments.

The Draft Appendix A also fails to disclose the unusual manner in which MWD is now establishing its budget and its rates, based not on actual projected water demand nor projected expenses, but on the basis of an arbitrary number that MWD itself expects to exceed in seven out of 10 years. This approach fails to even attempt to meet cost-of-service requirements in setting MWD's rates and charges, and instead, results in intentional, systematic revenue over-collection from MWD ratepayers, with ex-post facto decision-making by the MWD board of directors on how to spend the intentionally over-collected rate dollars without any cost-of-service standard of transparency, accountability or legality.

MWD also fails and refuses to track or account for revenues it receives from the different rates it charges for the services it provides. For this reason, it cannot and does not ensure that rate revenues are spent on the intended purposes. For example, funds over-collected from the System Access Rate and System Power Rate are being used to pay for water conservation programs that benefit supply service customers, rather than being used to set lower transportation rates in the following year. The cross-subsidy between services can be demonstrated by the fact that even though data stated in A-91 indicates MWD "water sales" (in which MWD improperly includes revenues from the transportation service it provides to the Water Authority) exceeded budget in five fiscal years between 2004/05 and 2013/14. In reality, MWD's actual water sales (i.e., not including revenues from the Water Authority's transportation service payments) exceeded budget in only three of those years. Unlike water demand, which is inherently more difficult to predict, MWD revenues from the transportation service it provides to the Water Authority are entirely predictable and do not vary because of hydrology. MWD's practice of comingling revenues from the different rates it charges causes illegal cross subsidies and results in rates that do not bear a reasonable relationship to the costs of providing a particular service. Each and every one of these practices results in illegal rates being charged by MWD.

Comments on Draft Appendix A

All references are to the page numbers in the draft redline copy of the Appendix A dated 11/06/14.

A-4: Drought Response Actions. The discussion in this section of the Official Statement is insufficient to advise a reader of the risks associated with MWD's dwindling imported and stored water supplies given the possibility of a continuing drought. The fact that MWD is projected to use between 1 million acre-feet (MAF) to 1.3 MAF of its available storage reserves in calendar year (CY) 2014 alone is material. While MWD notes that it declared a Water Supply Alert last February and doubled its conservation subsidy budget, it does not mention that these efforts have thus far failed to reverse the demand trend that will result in the consumptive use of more than one-half of its available storage reserves in 2014.

Appendix A should discuss and disclose how MWD plans to meet 2015 demands under these circumstances in the event that the drought continues. MWD should provide supporting facts, operational projections and the assumptions used to support its statement that the Colorado River Aqueduct is expected to operate at capacity, given that it projects that it will exhaust the bulk of its Lake Mead water storage in 2014. The analysis should include consideration of any delivery limitations MWD may experience in areas served exclusively by the State Water Project as well as MWD's plan to ensure that emergency storage reserves are preserved for their intended purposes (i.e. providing water service following a catastrophe that cuts off imported water supplies).

A-5: Integrated Water Resources Plan. Appendix A should disclose that it would be imprudent to make any long term water supply planning decisions based on the badly outdated 2010 Integrated Resources Plan (IRP). Although the Draft Appendix A mentions that the IRP is scheduled to be updated in 2015, it does not disclose the risks of continuing to make decisions based on outdated data that is known to MWD today – a material deficiency. Moreover, MWD has not even begun to conduct the necessary coordination with member agencies to update the plan. In the past, it has taken MWD about two years to complete the update. Without having a current long-term supply plan and accurate data taking into account changed circumstances, MWD is at risk of committing to pay for long-term water supply projects in excess of what its member agencies are willing to buy. The IRP also assumes that MWD will have revenues available from water rates that have been declared illegal. MWD has claimed in court filings that this has a "destabilizing effect on MWD's rates and its ability to budget and plan" (our December 9, 2013 letter is attached for your ease of reference; see pages 1-3 (Dec. 9 Letter)). If MWD actually believes its own representations to the Court, then this should be disclosed.

A-7: State Water Project. Appendix A should disclose that the Agreement in Principle reached to extend the State Water Project contract does not address cost allocation related to the Bay Delta Conservation Plan (BDCP). Depending on how BDCP costs are proposed to be allocated, MWD's share of the BDCP could vary widely and have a substantial impact on MWD's water rates and charges, and as a result, have a substantial impact on reducing MWD's future water sales. Since it is expected that the financing of BDCP will continue to be under a take-or-pay contract, MWD is at risk of being liable for payments far in excess of revenues that may reasonably be anticipated from water sales. In such a case, MWD would have no alternative but to find that increased taxes are necessary in order to ensure its fiscal integrity. These fiscal realities are capable of being addressed, and should be addressed in the Draft Appendix A.

A-15: Water Bond. Appendix A should disclose that the Water Bond will provide funding for local water supply projects that are anticipated to reduce demand for MWD water supplies.

A-32: Water Supply Allocation Plan. We have previously requested that disclosures be made regarding Preferential Rights that have not been made (Dec. 9 Letter, page 4). We renew our request that a more complete discussion of preferential rights be included in Appendix A. Disclosure should also be made of recent actions and communications from MWD member agencies with regard to enforcement of their preferential rights and the impact such actions would have on MWD's water supply planning, supply allocation and drought response.

A-49: Metropolitan Revenues: General. The MWD Act clearly limits property tax collections to the amount necessary to pay annual debt service on MWD's general obligation bonds, plus the portion of its State Water Contract payment obligation attributable to the debt service on State general obligation bonds for facilities benefitting MWD *that were outstanding as of 1990-91*. It is misleading to delete the qualifying language, "that were outstanding as of 1990-91." MWD should disclose that its own Chief Financial Officer, Gary Breaux, informed the MWD board prior to its vote in August of this year suspending the tax rate limitation that the action was *not* essential to the fiscal integrity of MWD. The action by the MWD board in suspending the tax rate limitation does not comply with Section 134 of the MWD Act. Further, it should be disclosed that the MWD board did not engage in any substantive discussion or deliberation of alternatives in order to achieve a "fair distribution of costs," and was provided with no data to support the conclusory statement by staff that suspension of the tax rate limitation would "enhance MWD's fiscal stability" or result in "a fair distribution of costs across MWD's service area."

A-53: Delta Supply Surcharge. The Delta Supply Surcharge was, as stated, designed to recover additional supply costs associated with pumping restrictions. Appendix A should disclose the financial risks associated with the board's suspension of the Delta Supply Surcharge, even though the pumping restrictions remain in place, especially in the context of the staff recommendation to change the terms of MWD purchase orders (action this month) to eliminate Tier 2 revenues, the original purpose of which was also to recover the high cost associated with obtaining additional water supplies. Both actions result in setting the Tier 1 water rate higher than the cost of providing that service. There is no rational basis for MWD reducing the rates associated with the costs of obtaining additional water supplies.

A-56: Member Agency Purchase Orders. Appendix A should disclose the purchase order modifications recommended by staff to be considered this month, including the financial impacts and risks associated with the elimination of MWD's Tier 2 revenues. MWD should also disclose that, during the trial of the Water Authority rate cases, MWD represented that Tier 2 revenues were a mechanism to ensure that all MWD member agencies pay their fair share of dry-year peaking costs. Since there has been no change in MWD's rates or cost of service, there is no explanation of how these costs will now be recovered except in the form of another illegal cross-subsidy.

A-56: Classes of water service. This section of the Draft Appendix A is inaccurate and materially misleading in several respects. First, MWD has multiple rates, including a Water Stewardship Rate, System Access Rate, and System Power Rate and Wheeling Rate. MWD also sells treated and untreated water. The costs that MWD incurs to provide these and other services, such as dry-year peaking, are not the same for all MWD member agencies. These differences are required to be identified and the associated costs properly allocated through a cost-of-service process to ensure that beneficiaries pay for the services they receive. MWD's simplistic statement that it has a single class of water service is not only inaccurate; it results in rates that are illegal under California law and exposes MWD to the continued risk of litigation.

A-58: Readiness-to-service Charge. Having disclosed that the RTS recovers only a portion of capital expenditures for infrastructure projects needed to provide standby service, Appendix A should also disclose how the remaining portion of these capital costs are recovered. In addition, the statement that the RTS recovers capital expenditures related to "peak conveyance" needs is inconsistent with MWD's rate memo; please explain this discrepancy and correct for it in one or both documents.

A-59: Financial Reserve Policy. MWD should disclose that the MWD board does not have unlimited discretion to determine how revenues are spent, through the creation of reserves, or otherwise; rather, all of MWD's rates and revenues are subject to California cost-of-service requirements under the common law, California statutes and Constitution. The planned over-collection of revenue and refusal to utilize balancing accounts or any other mechanism to account for and track revenues by rate category subjects MWD to the further risk of litigation.

A-62: Ten Largest Water Customers -Water Sales Revenues. It is highly misleading to characterize wheeling revenues as MWD "water sales." We have requested many times that you correct this summary so that investors are not required to figure out by reference to a small footnote that MWD's water sales are not as high as described.

A-63: California Ballot Initiatives- Proposition 26. Appendix A should include disclosure of the fact that Judge Curtis E.A. Karnow has already ruled that MWD is subject to Proposition 26 (2010). MWD should also disclose how or why, if it is not now subject to Prop. 26, it could "affect future water rates and charges."

We incorporate by reference all of our prior comments in prior letters to MWD that have not been corrected in this or past versions of the Official Statement.

Sincerely,

Michael T. Hogan Keith Lewinger

Michael T. Hogan Director	Keith Lewinger Director	Fern Steiner Director	Yen C. Tu Director

Attachment: Water Authority Comment Letter on MWD Draft Official Statement, dated 12/9/13

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

December 9, 2013

John (Jack) V. Foley 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 8-1: Authorize the execution and distribution of Remarketing Statements in connection with the remarketing of the Water Revenue Refunding Bonds (Index Mode), 2011 Series A-1/A-3 and 2009 Series A-2

Dear Chair Foley and Members of the Board:

We have reviewed the December 10, 2013 Board Memo 8-1 and the redline copy of Appendix A, and have determined we must again vote against the staff recommendation to authorize execution and distribution of the Official Statement in connection with the sale of bonds. We request that staff and bond counsel respond to each of the issues and questions presented in this letter.

General Comments

At the outset, we note that a number of comments we have provided in the past have not been substantively addressed by changes in Official Statement; we do not repeat all of the points here, but have included a list of our letters[i] (copies of which have previously been provided to the MWD staff and board) at the end of this letter and incorporate herein points not previously addressed by MWD management.

All references are to the page numbers in the draft redline copy of the Appendix A dated November 25, 2013.

Inconsistent statements by MWD in its Official Statement and pleadings filed in Court. In describing the litigation challenging MWD's rates, the Official Statement states that,

> "to the extent that a court invalidates Metropolitan's adopted rates and charges, Metropolitan will be obligated to adopt rates and charges that comply with any mandates imposed by the court. Metropolitan expects that such rates and charges would still recover Metropolitan's cost of service. As such, revenues would not be affected." (A-54)

In stark contrast to this representation, MWD has alleged in court filings that the Water Authority's lawsuit (or any member agency litigation) has a "destabilizing effect on MWD's rates and its ability to budget and plan." Further, that if the Water Authority were to prevail, it would, "threaten the current funding source for existing LRP, CCP and SDP project contracts and threaten future LRP, CCP and SDP contracts." Indeed, the impacts of the "destabilization" described in MWD's declarations and pleadings filed with the court is so great that MWD has alleged that it cannot ensure the continued administration of these programs or any of the long term investments described in its IRP if it should be required to change the cost allocation to its rates. See, for one example among many, the Upadhyay Declaration in Support of MWD's Opposition to SDCWA's Motion for Summary Adjudication at pages 7-8, (excerpt attached). Similarly, MWD's recent motion to exclude testimony by one of the Water Authority's experts states that, were the Water Authority's "proposed reallocation [of costs] to occur, member agencies would buy less water from MWD." Motion to Exclude Denham at pages 9-10 (excerpt attached).

There is no way to reconcile MWD's statements to bondholders on the one hand, and to the Court, on the other. It cannot at the same time be true that the Water Authority's rate litigation will have no impact on MWD's revenues, and at the same time, "destabilize" MWD and threaten its water supply programs and ability to budget and plan.

The real risk of destabilization. While we disagree as to the cause (it is not the result of the exercise of free speech by any member agency), we do believe that MWD is threatened by the kind of "destabilization" described in its court filings *as a result of its failure to have in place a long range finance plan and commitments by its member agencies to pay for the billions of dollars MWD is spending and plans to spend in the future.* This is not a new issue; it was well-described by an independent Blue Ribbon Task Force almost 20-years ago:

> *Reliability, quality and other water supply specifications cannot be made independently from the willingness of MWD customers to pay for such services*. Member agencies may want, for example, the insurance provided by major investments to increase MWD standby capacity, but if forced to commit funds for such capabilities, they may actually prefer far lower levels of protection than a hypothetically "costless" water supply guarantee. (page 9; emphasis in original)
>
> *Derive IRP results starting from a willingness to pay perspective as well as from reliability and supply goals to assess whether current planning efforts adequately "loop back" and force the reappraisal of initial reliability and other operational assumptions.* Member agencies, and other water users, may have a desire to improve reliability and performance capabilities beyond their willingness or ability to pay for such improvements. In the event of substantial divergences in various water users' willingness to pay for MWD capacities, Metropolitan may wish to consider more flexibly pricing wholesale

> water supplies to reflect the levels of reliability and cost burdens that each user desires and is willing to bear. Effective planning can only occur after the maximum level of current and future investment member agencies will bear has been determined. (page 14; emphasis in original)
>
> *The peaking charge should recover the actual economic costs generated by peaking behavior and not be set by political considerations.* (page 21; emphasis in original)
>
> …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. The wide variation in member agency local water supply and project options means that each agency will differently value MWD water and facility investments, a fact that can frustrate needed revenue agreements…[t]he Task Force was troubled to learn…that some of the member agencies most strongly supporting big-ticket projects…also had the most aggressive plans to reduce their future MWD water purchases and develop independent supplies. In effect, such agencies appear to want MWD to develop costly backup capacity-or insurance-for their local supply strategies, while seeking to shift the costs for these benefits on to Metropolitan and other agencies and consumers. (page 23)

We have raised these issues repeatedly in the boardroom and in past letters commenting on MWD's Official Statements. Among all of the concerns we have, the single greatest concern is MWD's failure to describe in its Official Statement, the risk associated with its continued spending at the same time ***its member agencies are clearly unwilling to commit to pay for its programs.*** We also believe that the extraordinary lengths MWD and its member agencies are going to in order to impede the development of water supplies in San Diego, independent of MWD, is information that should be made available to bond counsel (it has not been) as well as present and future purchasers of MWD bonds.

Comments on Draft Appendix A dated November 25, 2013

A-1 *Uniform rates for each of class of service.* Appendix A states that, [m]ember agencies request water from Metropolitan…*and pay for such water at uniform rates established by the Board for each class of service*" (emphasis added). This is the only place in Appendix A where the words, "class of service" are used. Please confirm whether the water "categories" described at A-57-58 are the "classes of service" referred to in the recital at page A-1.

A-6 *Standby or "dry-year peaking" demands of MWD member agencies.* Due to the compartmentalization of the disclosures in Appendix A, the reader might fail to associate the withdrawals from storage described in the last paragraph on page A-6 with the Water Authority's rate litigation; specifically, the issue of MWD's failure to account for or properly allocate the costs associated with having almost 6 million acre-feet of storage capacity and more than 3.3 million acre-feet of stored water available for withdrawal, which made possible the 300,000-500,000 acre-feet of water supply that MWD expects to draw upon to meet demands in 2013. The long-term negative impacts on MWD from its failure to identify and account for these costs are described in the Blue Ribbon Task Force Report, in the above excerpts and other portions of the Report. Appendix A should be revised to include a full discussion of this issue including potential impacts on MWD sales and rates.

A-11 Area of Origin litigation. Please provide us with a copy of the settlement agreement that is "currently being circulated among the parties for signature."

A-18 Second supplemental agreement with Coachella. Please provide a copy of the second supplemental agreement with CVWD referred to in the second full paragraph.

A-28 Storage capacity and water in storage. What accounts for the reduction in the storage numbers since last reported in May 2013?

A-30 Preferential rights and water supply allocation plan. The second full paragraph under Water Supply Allocation Plan should be revised to include disclosure that – except in a water shortage emergency declared by the MWD board under Section 350 of the Water Code (which has never happened), or any other statutory basis MWD may believe would support limitations on the exercise of preferential rights – the MWD board has no statutory authority or ability whatsoever to diminish the statutory preferential right to water held by each of its member agencies. It is highly misleading in the context of current water rates and realities to state that, "historically, these rights have not been used in allocating Metropolitan's water." The historical record is clear that the cities of Los Angeles and Long Beach have every intention of calling upon their respective preferential rights to water should it be advantageous for them to do so. The Water Authority does not question these rights, which have also been confirmed by legal opinions of MWD's General Counsel and the Court of Appeal.

A-32 Impact on MWD sales of Los Angeles updates reported in Appendix A. Two significant changes are made to Appendix A regarding the City of Los Angeles. First, that its "favored son" agreement executed by Ron Gastelum without the knowledge or consent of the board of directors, is expected to be completed six years sooner than previously disclosed. Second, that LADWP has reached a "major agreement" regarding future dust control on portions of Owens Lake. Please explain what has changed in the implementation of the AVEK agreement that accounts for the project now being completed before the end of next year (versus 2020 as previously reported in Appendix A). Please explain the impacts on MWD water sales as a result of each of these developments.

A-33 Local water supplies. The discussion of local water supplies generally is very confusing because it does not make clear to the reader what supplies are being developed by MWD (or with subsidies from MWD) and which are not. There should also be a discussion here that ties in to later sections of the Appendix A disclosing the impact on MWD sales from the development of local water supplies by the member agencies (with and without subsidies from MWD).

A-34 Impact on MWD sales of Carlsbad seawater desalination project. We were unable to confirm whether MWD's future sales projections take into account the 48,000-56,000 acre feet of water supply expected to come on line in 2016. Please identify where that accounting is made.

A-35 MWDOC application for MWD subsidies for a seawater desalination project. Please provide us with a copy of the application. Also, please provide an analysis (facts) of the regional benefits MWD believes would support the payment of such subsidies.

A-42 Discussion of MWD's capital investment plan (CIP) illustrates the need for a long range finance plan and updated cost of service analysis. The short CIP discussion reflects the wild fluctuations as a result of poor estimations by MWD staff of capital spending and the need for pay-as-you-go funding and water rate increases. Every one of these highly inaccurate estimations results in further distortion of MWD's already improper allocation of costs to its member agencies and all MWD ratepayers. It is also unclear – except possibly for litigation purposes – why MWD is claiming that it will spend zero dollars on "supply" over the next five years. Please advise whether the words, "Cost of Service," are used in a rate-setting context or, is intended to have some other meaning in this section of the Appendix A. Also, please advise why debt service for bonds MWD did not issue and does not expect to issue is included in the financial projections.

A-49 Risk management discussion is incomplete. As stated in multiple prior letters, we remain concerned with the inadequacy of MWD's overall risk disclosure. Many of the issues we have raised have not been addressed in the Appendix A. In particular, we remain concerned that MWD's long range finance plan is materially out of date (last updated in 2004). The draft Appendix A does not disclose that MWD is operating (by choice) without a long range finance plan because, after more than five years of working on it, MWD abandoned the effort (i.e., its member agencies could not agree on a long range finance plan to pay MWD's costs). Nor does MWD (by choice) have water rate projections that take into account and plan for all of MWD's projected costs and liabilities. These costs include, for example, some reasonable estimate of BDCP costs, other water supply programs included in the IRP, facility investments and retiree health. Almost 20-years has passed since the Blue Ribbon Task Force wisely cautioned MWD to develop and implement a plan for its fiscal sustainability; yet today, there remains ***no plan*** for how MWD expects to pay its costs over the long term. MWD's current ad hoc approach to financial planning is neither advisable nor sustainable and its continued spending creates a risk for all of Southern California including all of its bondholders.

A-50 MWD's actions in 2013 suspending the tax limitations in the MWD Act were not factually or legally justified. It is ironic that MWD chose to increase taxes (the net economic effect of suspending the limitation) at the same time that it was awash in cash from the over-collection of revenue from Southern California's water ratepayers. In June 2013, when MWD took the action to suspend the tax limitations, it had already collected $314 million more than needed to pay 100% of its budgeted expenditures and caused its reserves to exceed maximum reserve level by at least $75 million (see the Water Authority's June 5, 2013 letter RE Board Memos 8-1 and 8-2). As a matter of fact, additional tax revenue was most assuredly ***not*** "essential to the fiscal integrity of the district." The MWD board did not and could not make the findings necessary to support the suspension of the tax limitation, and any suggestion that the board considered in any meaningful or substantive way "factors" including the "balancing of proper mechanisms" for funding current and future State Water Project costs is unsupported by the record. If there is any document or record you believe supports this statement in the Appendix A other than the board memo, please provide copies to us in your response to this letter.

A-51 Wheeling revenues as an MWD "water sale." The Water Authority does not purchase its IID or canal lining water from MWD; it pays MWD to convey the water to San Diego. MWD's representation of these revenues as "water sales" are made for purposes of litigation only and are misleading bondholders, MWD's "disclosures" in the footnotes to its Summary of Receipts by Source notwithstanding.

A-52 Member agency purchase orders. The description of member agency purchase orders is misleading because it suggests that MWD's member agencies have made firm commitments to purchase water from MWD in the future when they have not. See discussion of this issue in prior letters commenting on the Appendix A.

A-53 Rate structure. Representations that uniform rates are collected "for every acre-foot of water conveyed by Metropolitan" are inaccurate because the rates do not take into account all of the discounted and special agreements MWD affords some but not all of its member agencies. Moreover, MWD fails to comply with cost of service legal requirements and its own act because it fails to properly acknowledge or account for different classes of service it provides to its member agencies (see comment at A-1 above, the only place in the Appendix A in which MWD mentions classes of service).

A-54 Litigation challenging rate structure. See general comments about the inconsistency between representations in the draft Appendix A and representations made to the Court.

A-60 Hydroelectric power recovery revenues. Why have the three paragraphs been deleted?

A-79 Tax increase to pay for additional payments under the State Water Contract. Please provide a copy of the opinion of MWD's General Counsel referred to in the first full paragraph that the tax increase as described would be within the exemption permitted under Article XIIIA of the State Constitution as a tax to pay pre-1978 voter approved indebtedness.

A-86 Projected revenues and expenditures. See question above, at A-34. Do these revenue projections assume that the Carlsbad seawater desalination facility comes on line in 2016? See also the questions above, at A-32. What assumptions are made about water sales to LADWP?

A-89 Long range finance plan. MWD's reserve policies are outdated, just as its 1999 Long-Range Finance Plan is. Is MWD staff relying upon and implementing all of the policies in the 1999 plan at this time?

Again, we incorporate by reference all of our prior comments which have not been corrected in this or past versions of Appendix A.

Sincerely,

Michael T. Hogan Director	Keith Lewinger Director	Vincent Mudd Director	Fern Steiner Director

Attachments

1. Declaration of Deven Upadhyay (excerpt), December 3, 2013
2. Motion to Exclude Testimony of Daniel A. Denham (excerpt), December 10, 2013

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

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[i] Water Authority comment letters on MWD's Official Statement dated: 9/22/2010, 12/9/2010, 5/16/2011, 8/22/2011, 2/13/2012, 4/9/2012, 6/11/2012, 8/20/2012, 8/29/2012, 10/8/2012, 11/5/2012, 2/11/2013, 5/13/2013, and 6/7/2013

were "to improve regional water supply reliability and avoid or defer MWD capital expenditures" and to meet "IRP local resource targets[.]" In that letter, SDCWA also recommended that MWD pay $250 per acre-foot of water under the project contracts to "reduce future MWD capital expenditures and water supply costs."

III. MWD's Integrated Rate Structure

26. MWD funds its demand management programs through revenue generated by its current, integrated rate structure which was adopted by MWD's Board of Directors in October 2001 and implemented as of January 2003 ("Existing Rate Structure"). Specifically, MWD's Water Stewardship Rate is set to recover costs related to its LRP, CCP, and SDP programs.

27. Piecemeal legal and/or legislative challenges to MWD's Existing Rate Structure would create a destabilizing effect on MWD's rates and its ability to budget and plan. This is the case because such challenges do not account for MWD's overall costs and policy considerations in setting its rates. In contrast, challenges to MWD's Existing Rate Structure within the Board process would allow for consideration of the larger picture by all of the relevant stakeholders. As a result, such challenges would not threaten to destabilize MWD's Existing Rate Structure in the way piecemeal legal and/or legislative challenges would. The RSI provision therefore protects the stability of MWD's Existing Rate Structure by encouraging resolution of rate disputes within the Board process.

28. Piecemeal legal and/or legislative challenges to MWD's rates that threaten to destabilize MWD's Existing Rate Structure also threaten the current funding source for existing LRP, CCP, and SDP project contracts and threaten future LRP, CCP, and SDP contracts. Without a stable rate structure, MWD cannot ensure the continued administration of the LRP, CCP, and SDP programs.

29. MWD relies on a stable rate structure to adequately plan, develop and budget for LRP, CCP, and SDP projects and its other capital and operating costs. MWD's MAs rely on a stable MWD budget and rate structure to plan their budgets and to set their rates. Challenging MWD's rates outside the Board process is the type of destabilizing effect the RSI provision is aimed at preventing. This kind of destabilization interjects uncertainty that interferes with long-

term planning and budgeting that is necessary to enter into the long-term LRP, CCP, and SDP project contracts. For example, if MWD were required to eliminate its Water Stewardship Rate, MWD would have to make fundamental changes to its Existing Rate Structure. In particular, absent changes in MWD's budgeted costs, MWD would have to increase its other rates to cover the cost of existing LRP, CCP, and SDP programs. This kind of unplanned for rate increase would interfere with MWD's and its MAs' ability to properly plan and budget for the future. To avoid such disruptive rate increases, MWD's Board would have to consider the possibility of having to decrease or discontinue its future investments in local conservation and resource development projects. This kind of uncertainty also inhibits MAs from investing in long-term projects that MWD needs to meet its long-term goals set forth in MWD's IRP.

30. SDCWA's assertion that MWD has the ability to reset its rates and adjust its rate structure to meet its costs does not obviate the need for the RSI provision. Resetting of MWD's rates is exactly the type of destabilization that the RSI provision was intended to prevent. Even if MWD's overall revenues would not be affected by a challenge to MWD's Existing Rate Structure, that does not mean that a challenge to MWD's Existing Rate Structure would not affect the revenues allocated to any particular program or service, including revenues available for MWD's demand management programs.

31. SDCWA suggests that the RSI provision is unnecessary because MWD could have simply increased its fixed rate charges to "provide a measure of revenue stability." The RSI provision is not aimed at protecting MWD's "revenue;" rather, it is intended to protect the stability of MWD's Existing Rate Structure to ensure continued funding of the LRP, CCP, and SDP programs, not some other, alternative hypothetical rate structure that MWD's Board did not adopt.

on MWD's supposed breaches of the Exchange Agreement. West Dec., Ex. H; *see also* West Dec., Ex. I at 332:22-333:20 (Mr. Cushman testifies that he has is testifying as to topics 7 and 8 in Metropolitan Water District of Southern California's Amended Notice of Deposition of Person Most Knowledgeable for San Diego County Water Authority (Exchange Agreement), concerning alleged breaches of the 2003 Exchange Agreement). He testified that there is no way to know what MWD's rate structure would look like if this Court accepts SDCWA's argument that State Water Project costs and the Water Stewardship Rate should not be allocated to MWD's transportation rates, or whether such a revised rate structure would be any more favorable to SDCWA than the current one:

> Presuming the Water Authority prevails [in the litigation], the judge will invalidate Metropolitan's rates, and Metropolitan will have to go back and set and adopt lawful rates. How Metropolitan goes back and adopts lawful rates and charges is at this point unknown. So how it might affect the Water Authority's payments is unknown.

West Dec., Ex. I at 443:20-444:2

Mr. Denham's assumption that MWD's rate structure would otherwise remain the same if State Water Project and Water Stewardship costs were moved from transportation rates to supply rates is completely speculative, which renders his opinion inadmissible. *Biren v. Equal. Emergency Med. Grp., Inc.*, 102 Cal. App. 4th 125, 138 (2002) ("Damage awards may not be based upon the testimony of experts who rely on speculation.").

Indeed, this assumption is not only speculative, Mr. Denham's admissions and basic economics refute it. Mr. Denham admits that, were these costs reallocated from transportation to supply as his report envisions, many member agencies will pay more overall for water obtained from MWD.[4] West Dec., Ex. B. at 183:12-15 ("It's reasonable to assume, as I've previously

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[4] Member agencies' rates would inevitably increase if State Water Project costs and the Water Stewardship Rate are moved wholesale into the supply rate. This is because, under Mr. Denham's assumptions, MWD would collect substantially less revenue for providing SDCWA with Exchange Water, while the rest of MWD's business -- including its revenue from other sources and its total operating costs -- remains unchanged. MWD is under a legal obligation to recover its costs through the rates it charges. *See* MWD Act § 134 (requiring MWD to set water rates at a level which will recover MWD's operating costs).

mentioned that the misallocated components go to supply. And with the supply rate going up, member agencies pay more . . . ."). Mr. Denham admits the existence of price elasticity, which in this context indicates that as MWD's rates increase, member agencies will buy less water from MWD. *Id.* at 171:22-25 ("Q. And you agree with the concept that all else being equal, the quantity of a demand good falls when the price of a good rises, correct? A. That's correct."). He also admits that MWD member agencies -- particularly one of its largest, the City of Los Angeles -- exhibit such price elasticity with regard to their water purchases from MWD. *Id.* at 174:13-22.

Thus, logically, were Mr. Denham's proposed reallocation to occur, member agencies would buy less water from MWD. If that occurred, MWD would likely have to adjust its rate structure to address depressed sales, since it must recover all its costs through its rates. Mr. Denham's opinion addresses this problem by simply pretending it does not exist:

> Q. But you didn't take this [effect of price elasticity] into account at all on your expert report, did you? A. I did not. MR. BRAUNIG: Objection; vague and ambiguous. THE WITNESS: That's not what I was asked to do.

Id. at 172:1-6. To the contrary, he assumes that the quantity of water purchased by the other member agencies will remain static,[5] even as the price increases:

> Q. So you were asked to assume that prices remain -- that sales volumes would remain the same although prices went up? A. I -- MR. BRAUNIG: Objection to the form. BY MR. WEST: Q. Yes? A. Yes, all things would remain equal.

Id. at 172:8-15. Here again, Mr. Denham's opinion rests on a key assumption that he admits is false. Thus, Evidence Code Section 803 requires that the opinion be excluded. *See Maatuk v.*

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[5] For each calendar year 2011-2014, Mr. Denham divided MWD's "revised" revenue requirements by the total number of acre-feet estimated to be sold to member agencies in that year -- *e.g.*, in 2011: "When MWD's revenue requirement of $453,296,142 for these cost elements **is spread over the total number of acre-feet in the 2011 sales assumptions contained in the COS Report**, a bundled credit of $236/AF should be returned to the Water Authority, or $33,805,324 as an overcharge for transportation in calendar year 2011." West Dec., Ex. A, at Ex. B Thereto (Denham Report), 7 (emphasis added). He performed the same calculation for 2012, 2013, and 2014 -- again using sales assumptions contained in the Cost of Service Reports for those years -- and then added together the results to arrive at a total "overcharge" of $188,340,476. *Id.*

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March 7, 2014

The Honorable Darrell Steinberg
President pro Tempore
California State Senate
State Capitol, Room 205
Sacramento, CA 95814

The Honorable John A. Pérez
Speaker
California State Assembly
State Capitol, Room 219
Sacramento, CA 95814

Re: METROPOLITAN WATER DISTRICT PUBLIC HEARING ON SUSPENSION OF TAX RATE LIMITATION

Dear President pro Tem Steinberg and Speaker Pérez:

We represent the San Diego County Water Authority on the board of directors of the Metropolitan Water District of Southern California (MWD or district). We are in receipt of MWD's letter advising you of the public hearing on its recommendation to suspend the tax rate restriction for the next two years, based on a finding that a tax rate in excess of the restriction is "essential to the fiscal integrity of the district."

We strongly support MWD's desire to increase its fixed revenues, which are currently less than 20% of total revenues, while its fixed costs are more than 80% of its total costs. However, we do not support the ad hoc suspension of the tax rate given the absence of a long range finance plan (MWD's finance plan was last updated in 2004). The Legislature has given MWD the specific authority to impose other fixed charges, including a standby charge, and we believe that should be considered at the same time as suspension of the tax rate restriction. Indeed, MWD's Chief Financial Officer confirmed at our last board meeting that MWD has many revenue funding options and that suspension of the tax rate limitation is *not essential* to maintain MWD's fiscal integrity.

There will certainly be no harm to MWD this year if it takes the time to develop a long range finance plan; by June 30, MWD's own projections show that it will have cash reserves of $800 million. Over the past two years alone, MWD collected $600 million more from its ratepayers than it needed to fund *all* of its planned and budgeted spending, as a result of underestimating sales and overestimating its expenses.

Finally, you should be aware that, on February 25, San Francisco Superior Court Judge Curtis Karnow issued a tentative ruling that MWD's 2011, 2012, 2013 and 2014 rates violate the California Constitution (Proposition 26), California statutes (including the wheeling statutes) and common law that all require MWD set its rates based upon cost-of-service. That decision is expected to be finalized within the next few weeks. These rates, now invalidated by the Court, are the very rates that MWD relies upon for more than 80 percent of its revenues and that are responsible for MWD's over-collection of hundreds of millions of dollars from its ratepayers.

For all of these reasons, we do not believe that suspension of the tax rate limitation is essential to the fiscal integrity of the district; however, we do believe that a long range finance plan is essential to the fiscal integrity of the district. In order to responsibly plan for the future, including a Delta fix, MWD's fiscal house must be in order.

Very truly yours,

Fern Steiner
Director

Vincent Mudd
Director

Keith Lewinger
Director

Michael T. Hogan
Director

cc: San Diego Legislative Delegation
MWD Board of Directors
SDCWA Board of Directors