**Proposed Staff Recommendation Consent Calendar for July 26, 2012**

**ADMINISTRATIVE AND FINANCE COMMITTEE**

9- 1. Treasurer’s report.
   Note and file the monthly Treasurer’s report.

9- 2. Adopt Resolution setting the time and date for a Public Hearing to consider amendments to the San Diego County Water Authority Local Conflict of Interest Code.
   Adopt Resolution No. 2012-___ setting the August regular meeting of the Administrative and Finance Committee as the time and date of a Public Hearing to consider amendments to the San Diego County Water Authority Local Conflict of Interest Code.

   Adopt Resolution No. 2012-_____ ratifying and approving amendments to and extension of the Memoranda of Understanding with the Teamsters Local 911 Union representing the Technical/Support, Professional/Administrative, and Managerial/Supervisory Bargaining Units. Approving Compensation Plan adjustments for Executive, Senior Management, and Confidential Employees; and Approving Classification and Salary Schedules for the period July 1, 2012 through June 30, 2015. Adopt Resolution No. 2012-__ as required by CalPERS for paying and reporting the value of Employer Paid Member Contribution. Adopt Resolution No. 2012-__ as required by Internal Revenue Service confirming the tax treatment of payments for employee’s mandatory cost share of employer contributions to CalPERS.

**ENGINEERING AND OPERATIONS COMMITTEE**

   Authorize the General Manager to award a construction contract to L.H. Woods & Sons, Inc. in the amount of $842,222 for the Miramar Pump Station Meter Vault project.

9- 5. Professional services contract for design of the Nob Hill Improvements project.
   Authorize the General Manager to award a professional services contract for $988,000 to Hatch Mott MacDonald for design of the Nob Hill Improvements project.
9- 6. **Change Orders to Shimmick/Obayashi Joint Venture for the San Vicente Dam Raise Package 3 – Roller Compacted Concrete Dams and Appurtenant Facilities project.**
Accept Shimmick/Obayashi Joint Venture Change Orders 19 through 22, 24 and 25 for a credit of $156,139; and authorize the General Manager to reduce the contract value by $2,946,000 for roller compacted concrete and marina quarry unit price items, decreasing the authorized contract amount from $143,783,933.70 to $140,681,794.70.

9- 7. **Professional services contract with Parsons/Black and Veatch Joint Venture for the ESP - San Vicente Dam Raise and Carryover Storage project.**
Accept no-cost Amendments 1 and 2, and approve Amendment 3 in the amount of $3,194,843 to provide additional construction management, inspection, and materials testing services for the ESP – San Vicente Dam Raise and Carryover Storage project due to work activity extensions, increasing the contract amount from $28,561,000 to $31,755,843.
Attached please find the Technical Memorandum referenced in the previously distributed Board memo: *Energy Use and Pricing in the Carlsbad Desalination Project, Agenda Item II 1-B*, to be heard at the Water Planning Committee’s July 26, 2012 meeting.

This Memorandum summarizes and supplements the analyses that will be presented at the July 26th Water Planning Committee meeting regarding the proposed assignment of energy risk in the Draft Water Purchase Agreement with Poseidon Resources. The analyses include: projections of future energy costs; the sensitivity of the cost of desalinated water to increases in electricity rates; and strategies to manage energy price risk.

The Memorandum was prepared by Clean Energy Capital, the Water Authority’s Project Advisor for the Carlsbad Desalination Project. The analyses will be presented to the Water Planning Committee by Clean Energy Capital’s Managing Director, David Moore PhD. Dr. Moore has extensive experience in energy pricing, energy infrastructure development and investment banking. Prior to forming Clean Energy Capital, Dr. Moore headed Citigroup’s renewable energy finance division and held senior positions at several other international investment banks specializing in energy infrastructure investments.
July 24, 2012

Attention: Water Planning Committee

Technical Memorandum
Analysis of Energy Use and Pricing in the Carlsbad Desalination Project

Purpose
The purpose of this technical memorandum is to provide additional analysis of the energy related costs of the Carlsbad Desalination Project, the sensitivity of the unit cost of desalinated water to fluctuations in energy pricing and potential strategies to manage the risk of energy price increases.

Background
At the July 26, 2012 Water Planning Committee, staff and Clean Energy Capital will present an initial analysis of the key factors related to the cost of electricity in the Draft Water Purchase Agreement, sensitivities to future trends in electricity price and strategies for managing the risk of electricity price increases. Staff provided the Water Planning Committee with a July 18, 2012 Information Memorandum providing a comparative context for evaluating energy use in the production, transmission and treatment of water.

This Technical Memorandum outlines the results of Clean Energy Capital’s due diligence efforts and sensitivity analysis on energy price related issues specific to the Carlsbad Desalination Project.

Discussion
Electricity Price
San Diego Gas & Electric (SDG&E) is expected to provide electricity services to the Project. SDG&E offers a variety of tariff structures for residential, commercial and industrial consumers: the “ALTOU+EECC” tariff provides the lowest cost of power for the Project. Within the ALTOU+EECC tariff, the Project will be further classified to reflect its large electricity demand and its proximity to a to-be-constructed electricity substation.

The ALTOU+EECC tariff comprises a basket of charges that collectively establish the electricity price. Many of these charges vary with season (summer versus winter) and with time of day (on-peak, semi-peak and off-peak). The Project’s expected 24/7 operations take significant advantage of semi-peak and off-peak power pricing, especially during the summer months when SDG&E’s tariff structure most incentivizes off-peak power consumption. Round-the-clock operations significantly reduce the Project’s electricity cost versus typical consumers whose electricity demand requirements coincide with on-peak time of day.

The estimated average electricity price for the Project, based on a minimum demand commitment from the Water Authority of 48,000 AF/year, is 9.29 cents/kilowatt hour (kWh). Because of the Project’s large demand and round-the-clock operation, its estimated electricity price is significantly lower than the 14.38 cents/kWh SDG&E industrial average reported by the California Energy Commission.
Electricity Consumption
Poseidon will bear the risk of electricity consumption. The Water Purchase Agreement (WPA) will specify electricity consumption allowances for the Project, taking into account raw seawater conditions and plant operating mode. Poseidon will bear the risk that the Project requires more electricity to produce desalinated water, and will benefit if the Project uses less electricity. This provision is intended to protect the Water Authority from electricity consumption risk, while incentivizing Poseidon to operate the Project efficiently.

The electricity consumption allowances in the WPA will match the energy consumption guarantees provided by IDE as plant operator. The electricity consumption allowances are intended to incentivize Poseidon to operate the plant efficiently by providing a modest profit opportunity to Poseidon if the plant is run in an efficient manner. Actual energy use is expected to be somewhat less than the consumption allowances specified in the WPA, with the profit shared between Poseidon and IDE. The WPA will provide for a “true-up” of the electricity consumption allowances after three years of operations and based on actual operating experience to confirm that energy consumption savings versus the contractual allowance are no greater than intended.

The Electricity Charge
The Electricity Charge will be the product of the electricity price and the electricity consumption amount, expressed in dollars per acre foot (AF).

The Water Purchase Agreement divides these charges into two categories:

- The **Fixed Electricity Charge** comprises those elements that are incurred whether or not the Project is producing desalinated water. These charges are part of the fixed cost of the Project.

- The **Variable Electricity Charge** comprises the remaining elements that are directly associated with water production. These charges are part of the variable cost of water.

The Water Authority will make no payments to Poseidon unless the Project is capable of producing desalinated water meeting the Water Authority’s acceptance standards (Product Water). For the Product Water it receives, the Water Authority will pay a Unit Price including both the Fixed Electricity Charge and the Variable Electricity Charge. In the event that the Project is available but the Water Authority doesn’t accept Product Water, the Water Authority will pay Poseidon the Fixed Electricity Charge, unless the Water Authority’s failure to accept results from a force majeure event.

Historic Electricity Prices
Table 1 shows average Industrial rates for SDG&E for the nearly 30-year period running from 1982 to 2010. The historical average rate of increase was 1.18%, meaning that the electricity price actually grew more slowly than monetary inflation over the same period. Relative to other goods and services, electricity has actually become less expensive over this timeframe.

Future Electricity Prices – Key Drivers
The Unit Price of water will vary with future electricity prices over the 30-year term of the WPA. Staff considers the primary drivers of future electricity prices to be:
• **Renewable Portfolio Standard (RPS).** SDG&E is committed to increase its renewable energy production to 33% by 2020. Renewable energy typically costs more than conventional generation, with the cost differential partially offset by federal subsidies. The cost of pursuing RPS is expected to increase the rate of electricity price escalation versus historical experience, especially in the early years of the 30-year rate forecast period. Because renewable energy is produced with little or no fuel cost, the high-cost implementation period during which renewable energy generating resources are constructed and placed in service is expected to be followed by a period of low electricity price escalation.

• **AB 32 Compliance.** Assembly Bill 32 (AB 32), the California Global Warming Solutions Act of 2006, will phase-in a carbon credit cap-and-trade system for targeted California emitters including SDG&E. SDG&E expects that a significant portion of compliance costs will be borne indirectly, as SDG&E lowers its carbon emissions in pursuit of RPS objectives. However, AB 32 compliance is expected to have a generally upward pressure on future electricity prices.

• **Natural Gas Prices.** Favorable developments in the long-term availability of natural gas are expected to exert an offsetting influence to the upward pressures of RPS and AB 32. SDG&E generates 60% of its electricity through the combustion of natural gas. The efficiency of combined-cycle gas turbine power plants (which produce up to 50% less carbon emissions than coal) together with the vast recent expansion of US natural gas reserves, are expected to make natural gas the key replacement of coal-fired power plants in the United States and the key driver of future electricity prices. Natural gas currently trades at $2-$2.50 per million British thermal units (mBtu), down from a high of more than $12/mBtu in 2008, and is expected to eventually settle at $4-5/mBtu. Most electricity price forecasts done prior to 2010 are now flawed because of the recent dramatic change in the natural gas market in the U.S.

• **Demand-Side Response.** Demand-side response refers to the “price elasticity” of demand for electricity over the longer term. As electricity prices increase, the financial incentive to conserve energy also increases, thereby reducing demand growth. This factor tends to lower the rate of electricity price escalation, especially over longer forecast periods.

• **Rate-Setting Process.** SDG&E, as an investor-owned utility (IOU), lacks the authority to establish rates and charges. This authority is instead vested with the California Public Utilities Commission (CPUC). CPUC’s rate-setting authority is expected to significantly constrain sustained electricity price escalation. SDG&E presents its rate case to the CPUC every three years, and may reasonably expect to receive rate increases in the 3 – 6% range, implying an annualized rate of increase of 1 – 2%. While higher rate increases may be granted from time to time, there is no history of the CPUC granting sustained and recurring rate increases significantly above this range. SDG&E’s 30-year historic average rate of increase of 1.18% for its industrial tariff implies an average rate case increase every three years of approximately 3.60%.

**Future Electricity Prices – California Energy Commission Projections**
The California Energy Commission produced a low, medium, and high forecast of SDG&E industrial electricity prices from 2010 to 2022 as part of its 2011 demand forecasting exercise. The scenarios incorporate variations in the key price drivers discussed above, and are shown in Table 1. The
Commission forecasts electricity price increases as ranging from 0.5% to 1.7% annually over this period.

Future Electricity Prices – Staff Projections
Clean Energy Capital has prepared three forecasts of electricity prices for the term of the WPA, shown in Table 2. The Mid Scenario forecast is used in the base case financial proforma. Actual rate increases cannot be predicted with certainty: rate increases may be below the low scenario projection or above the high scenario projection. Please see important disclaimers at the end of this memorandum.

- **Low Scenario.** The Low Scenario forecasts future electricity prices based on a repetition of historic average increases in SDG&E’s average industrial rate. In this scenario, the electricity price is projected to grow at 1.18%. Treating the actual historic escalation rate as a “low case” is intended to support conservative planning by the Water Authority, as it emphasizes the likelihood that future electricity escalation will be higher than historic experience given the upward price pressure of RPS and AB 32 compliance.

- **Mid Scenario.** The Mid Scenario forecasts future electricity prices based on significant electricity price escalation associated with implementation of RPS and AB 32. Electricity prices are assumed to escalate over the next 15 years at 3% annually (implying 5 successive CPUC rate cases increases above 9%) followed by a reversion to the historical escalation rate of 1.18%. The blended average escalation rate of 2% is levelized over the forecast period for modeling purposes. This rate forecast is more conservative (meaning it shows higher prices) than the California Energy Commission forecast, and implies a future escalation rate that is 170% of historical experience.

- **High Scenario.** The High Scenario forecasts future electricity prices based on extreme implementation of RPS and AB 32, with minimal offsetting influences from natural gas prices, demand-side response, and rate-setting process. Electricity prices are assumed to escalate over the next 18 years at 3.4% annually, double the escalation assumed by the California Energy Commission in its “high case” and implying 6 successive rate-case increases of more than 10%. The High Scenario projects electricity price escalation at 2.38%, more than twice the historical escalation rate.

Strategies for Managing Electricity Price Risk in the Carlsbad Desalination Project
The WPA provides the Water Authority the right to direct the Project to purchase power from alternative suppliers to SDG&E, or to itself provide electricity services to the Project. This right to direct electricity supply mitigates electricity price risk by giving the Water Authority independence from SDG&E.

Staff and Clean Energy Capital have made preliminary investigations into the feasibility of third-party power supply to the Project. It is expected that SDG&E would continue to provide transmission and distribution services, unless the Project developed a “behind-the-fence” electricity supply solution with a generating resource located adjacent to the plant site. Independent power supply options include natural gas generation, which might be combined with a vertical integration strategy of owning in-the-ground natural gas reserves and implemented in partnership with a California municipal electric utility. Independent power supply options might also involve renewable generation, although the Project’s round-the-clock demand requirements would be challenging for
intermittent renewable resources such as wind or solar. In addition to independent power supply, the Water Authority could also develop a self-generation energy solution integrated into its water conveyance activities.

Any third-party power supply away from SDG&E would involve complex regulatory, environmental, and project development activities. The cost of these activities, and their impact on the resulting cost of electricity supply to the Project, have not been quantified.

**Sensitivity of Desalinated Seawater Unit Price to Electricity Price**
Table 3 shows the sensitivity of the Electricity Charge component of the Water Unit Price to variations in future electricity prices, based on the various cases for SDG&E supply discussed herein.

Prepared by: Clean Energy Capital
## Table 1: Electricity Price History and CA Energy Commission Projections

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### Escalation

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(1) Average Industrial Electric Prices for SDG&E in Nominal Cents/kWh. Source: California Energy Commission

(2) From Table 1.1.9 Implicit Price Deflators for Gross Domestic Product. Source: US Bureau of Economic Analysis

(3) Projected SDG&E Industrial Rates in 2010 Cents/kWh. Source: California Energy Commission

(4) "Longer Run" projection of personal consumption expenditures price inflation. Source: Federal Reserve: Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents, June 2012
Table 2: Clean Energy Capital Projections

Projected Electricity Price for Carlsbad Desalination Project

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1.18%  2.00%  2.00%  2.38%  2.38%
Table 3: Water Unit Price Sensitivity

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Assumptions:
- Annual Acre-Foot Production: 48,000
- Annual KWh Consumption: 253,438,618
- kWh / Acre-Foot: 5,280
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Sacramento

2012/13 Budget and Governor's Initiative – As reported last month, the Legislature passed an on-time budget (budget bill and 6 budget trailer bills) on June 15th. A week later, the Legislature completed their work on the FY 2012/13 budget by passing an additional 21 budget trailer bills. The budget is balanced predicated on the passage of the Governor's November tax initiative. If the November ballot measure fails, there are $6 billion worth of budget trigger cuts that would impact schools, higher education, and various public safety programs.

Water Bond – One of the final actions of the Legislature prior to leaving on summer break was to pass legislation moving the 2012 Water bond to the November 2014 ballot. The measure was passed on a 2/3 bipartisan vote. No changes were made to the bond other than to change the dates for the election.

Legislative Calendar – The Legislature had a busy two weeks in late June/early July prior to leaving on summer break. The Legislature will return to session on August 6th and will end on August 31st. The final month of session should be hectic as usual. Since this is the final year of a two-year session, any bills that do not pass by August 31st will be dead.

Washington, DC

BDCP Developments Prompt Dueling Congressional Letters – Members of Congress are weighing in on efforts to revise the Bay Delta Conservation Plan (BDCP) to defer some decisions while proceeding with infrastructure. The proposed revision is an attempt to meet a statutory February 2013 deadline for completion of the BDCP.

On June 22, twelve members of the California Congressional Delegation – most of whom represent Northern districts – wrote to Secretary of the Interior Ken Salazar and Acting Secretary of Commerce Rebecca Blank urging no finalization of this proposal until more information is provided and discussed. The letter also disputed the legal basis of the proposed plan.
Senators Feinstein and Boxer weighed in against any further delays to the BDCP process, restating their support for the goals of restoring the Delta and securing water supply reliability. They further urged the prompt identification of a preferred project and the completion of draft environmental documents for public comment. Representative Grace Napolitano sent a similar letter urging that the BDCP process move forward quickly, but also urging the continued engagement with all stakeholders.

In addition to the congressional letters, other stakeholders from across the state have spoken out on the proposed revision to the BDCP plan. The federal agencies have not publicly responded to these comments.

**Appropriations Work Done Until November** – Senate Majority Leader Harry Reid announced that he would not bring any additional FY2013 appropriations bills before the chamber until after the November elections. This includes the Interior & EPA and Energy & Water Development bills. While criticizing the Senate’s move, Republican leaders in the House essentially followed suit, saying that they would not bring other appropriations to the floor after passing the defense bill until after Election Day. After its August recess, Congress will pass a short-term Continuing Resolution to maintain federal government operations into November.

Following the elections, leadership in both chambers and the President will need to work out a resolution to the spending calendar. One option is to pass an FY2013 omnibus appropriations act addressing all of the individual spending bills. Another option may be to pass another short-term Continuing Resolution that would provide further funding until a new Congress convenes in 2013. Exactly how long such another extension of funding, and at what level of funding to peg that continuation, will be a hotly debated issue later this year.

**Corps Report Considers Integrated Water Resources Management in Planning** – The U.S. Army Corps of Engineers released a conceptual paper examining the use of integrated water resources management as a part of the Corps’ planning framework. The paper is a response to concerns raised by the National Research Council. The Council noted the need to re-focus attention in planning studies to multiple objectives and tradeoffs, better accounting for uncertainty, accommodating the concepts of adaptive management, stakeholder collaboration, and systems analysis for watershed scale planning and evaluation.


**House Passes Small-Scale Hydropower Bill** – The House unanimously approved HR 5892, a bill that would streamline the permitting process for small-scale hydropower projects. The bill would exempt in-conduit hydropower projects less than 5 MW from regulation by the Federal Energy Regulatory Commission.

The bill is intended to simply efforts to install hydropower projects in canals, irrigation channels, and pipelines. Similar legislation (S 629) cleared the Senate Committee on Energy and Natural Resources last year, but has not advanced to a vote before the full Senate.
July 25, 2012

Attention: Imported Water Committee

Metropolitan Water District Delegates’ Report (Information)

Background
The MWD committees and board met on July 9 and 10. To accommodate the establishment of the tax rate, the board adjourned the August Board meeting to August 21; the next regular MWD board and committee meetings are now scheduled for August 20 and 21.

Discussion
This report summarizes discussions held and key decisions made at the July MWD committee and board meetings, as reported by the MWD delegates. The delegates supported seven of nine action items approved by the MWD Board. The delegates opposed staff’s recommended option to negotiate a 50-year use agreement with the Los Angeles Department of Water and Power (LADWP) to rehabilitate and use its existing lagoons and later build two new lagoons. The delegates also abstained on an item related to an agreement with the Department of Water Resources for repair and rehabilitation of the State Water Project.

Attachment 1 is a copy of the July committee and board meeting agendas and MWD’s summary of actions.

Communications and Legislation Committee
General Manager Jeffrey Kightlinger recapped the legislative year, focusing on the Hoover Power Allocation Act, which was signed into law and cemented an electric power-sharing agreement that will ensure energy security for MWD and other entities in Arizona and Nevada until 2067. The committee also received reports on other State and federal legislative activities. Executive Legislative Representative Kathy Cole reported that Governor Brown signed the bill delaying the vote on the $11 billion water bond initiative until 2014. Director Brick (Pasadena) questioned MWD’s strategy as it pertains to Senator Lois Wolk’s (D-Davis) comments on potentially trimming down excess “pork” tied to the proposed bond. Kightlinger said that MWD and the water community would take a hard look for areas that could be pared down in anticipation of a potential redraft of the bond initiative. Cole added that the discussion would also include the State’s bonding capacity and the status of repayment of existing bond funds, such as the State Water Project, which is being made by Project beneficiaries, rather than by the general taxpayer.

Engineering and Operations Committee
The committee and board approved five items – three related to repair and rehabilitation projects, including the standby generator at the Julian Hinds Pumping Plant on the Colorado River Aqueduct. The committee and board also approved a five-year reimbursable agreement with the California Department of Water Resources (DWR) for an amount not to exceed $25 million. MWD has been repairing and rehabilitatating State Water Project (SWP) facilities under an existing agreement with DWR. This new agreement would also authorize MWD to hire subcontractors and consultants as needed. Staff said a joint value engineering study was also being conducted by MWD and DWR. At the committee, the delegates abstained and asked for additional information
including what are the major differences between the expiring and proposed agreement, a summary of expenditures and reimbursements under the expiring agreement, and a copy of the actual expiring and proposed agreement. The delegates subsequently abstained on this item at the board because the information was not provided. MWD staff reported they would return to the Engineering and Operations Committee in August with the information.

The committee and board also approved an item to enhance solids handling capability for the Jensen Treatment Plant. Two alternatives were considered – to proceed with staged on-site solids handling facilities at MWD’s Jensen site or to pursue a long-term lease at LADWP’s site, next to Jensen. Discussion ensued over the operational reliability and the cost of sewage disposal. Due to LADWP site having a higher groundwater level, concerns were raised over impacts to the lagoon construction and operation. Chief Operating Officer Debra Man responded that LADWP is motivated to demonstrate an effective groundwater management system. However, if after two years the groundwater system specified for the LADWP site does not meet the terms of the agreement, this option could be terminated and staff would return to the Board to request authorization to proceed with the on-site facility and terminate the use of the soccer and baseball fields currently located on MWD’s property. She also said that LADWP is responsible for sewage disposal until 2024 when MWD is scheduled to complete the construction of the two new lagoons at the LADWP site and the on-site mechanical dewatering facility at the Jensen plant. Staff also indicates that this off-site approach may allow deferral of the mechanical dewatering facility, also deferring up-front capital expenditures. However, by constructing an on-site Solids Dewatering Facility and Lagoons project at Jensen, MWD would have control over its facilities and thus minimizing potential risks, as well as would not be faced with the potential problems caused by the higher groundwater level at the LADWP site. Responding to Director Little’s (West Basin) comment on the improved water quality resulting from the Delta fix, Man said that the agreement allows phasing to accommodate source quality changes. Man added that staff anticipates returning to the committee in August with the final terms of the agreement for board approval. The delegates did not support the leasing option, instead preferring placing the solids handling facilities on MWD’s own property.

**Finance and Insurance Committee**

MWD staff reported that as a result of Moody’s recent downgrading of a number of banks, a number of MWD holdings were devalued. MWD’s external portfolio managers were able to sell most of those holdings at a gain of about $213,000. Four holdings remain, two that mature at the end of the month, and two Morgan Stanley holdings, which staff reported the managers are confident that they will achieve a positive return.

MWD Controller Tom DeBacker reported the fiscal year 2011/12 water sales are under budget at about 1.677 million acre-feet (maf) compared to the projected budget of 1.8 maf; firm MWD water sales, excluding the Water Authority’s QSA transfer of about 163.3 thousand acre-feed (taf) and 225 taf of replenishment water, are approximately 1.289 maf. Firm water sales ended the year 123 taf below MWD’s firm sales budget of 1.8 maf. DeBacker said the fiscal year 2011/12 expenditures of $1.327 billion were under budget by about $116.4 million, mostly due to decreased State Water Contract expenses ($77.7 million), which include Delta Habitat Conservation and Conveyance Program and Bay Delta Conservation Plan costs, reduced Demand Management costs ($17.7 million), and reduced Colorado River Aqueduct power costs ($15.4 million). DeBacker said that the $1.404 billion in receipts were also under budget by about $56.7
million, mainly as a result of the projected lower water sales of $92.9 million, offset by about $24.3 million in other revenue (Coachella Exchange Sales and Hedge fund deposit), $9.5 million in power sales resulting from higher SWP allocations, and $9.1 million in taxes. The committee also received an update on rate refinement workgroup meetings with MWD member agency and sub-agency managers and representatives. Staff reported that MWD could manage its financial challenges through its current rate structure and that renewal of purchase orders is unnecessary. In addition, staff said by linking its rate structure with water management actions, Tier 2 could be imposed only when hydrological and operational conditions warrant. Director Lewinger later asked staff to return to the committee with a definition of year types as it applies to Tier 2 and who would be responsible for costs incurred. Director Evans (Western) questioned the cause of the dramatic drop in staff’s presentation of the Ad Valorem tax rate “status quo” scenario. Staff said MWD’s Act recovers debt service associated with the original SWP bonds and MWD’s general obligation bonds; as the combined debt service drops, the Ad Valorem responds commensurately. As a result of Evans follow-up question, Deputy General Counsel Syd Benion said that under the Act, the board can make an annual determination (following notification to the Legislature and public) setting the tax rate higher than the status quo if it declares it is essential to the fiscal integrity of the district; otherwise, MWD cannot exceed the statutory cap on MWD’s taxing authority. Kightlinger added that rather than making an annual determination to set the Ad Valorem tax rate, the board could also elect to change the MWD Act. Kightlinger said that an informational letter regarding the annual determination will be presented to the committee in October and staff’s final recommendations will be presented for committee and board consideration in November. Chair Grunfeld (Los Angeles) then acknowledged a letter submitted by the Water Authority (see Attachment 2); Director Wilson requested that the letter be entered into the administrative record of the committee. The letter expresses the Water Authority’s concerns over MWD’s fiscal stability and requests a board workshop be scheduled as part of next month’s Finance & Insurance Committee meeting to consider the elements and priorities of a Long Range Finance Plan (and rate refinement).

Staff also reported on its annexation policy, highlighting the two ways to annex into MWD – “automatic” by virtue of annexing to a member city or by consent of the Board. Also covered by staff were potential upcoming annexations, including two by the Water Authority, which impose low additional water demand on MWD.

**Legal and Claims Committee**
The committee and board approved the General Counsel’s Business Plan for fiscal year 2012/13, which includes efforts to manage outside counsel costs for representation on the Water Authority rate litigation. In closed session, the committee received reports on the Consolidated Delta Smelt Cases and the rate litigation with the Water Authority, in which no action was taken.

**Water Planning and Stewardship Committee**
During the committee’s public comment, Charlie Wolk, California Avocado Commission Water Committee Chairman, encouraged MWD to obtain closure with the Delta fix. Wolk stated that a study commissioned by the avocado growers shows production drops once Total Dissolved Solids (TDS) gets above 500 parts per million; with Delta water reliability, the goal of maintaining less than 500 ppm TDS is attainable. The committee and board also approved three items – including payment for MWD’s share of costs to participate in the Colorado River Board and the Colorado River Authority. The other two items were related to water sale agreements with entities outside
of MWD’s service area – United States Forest Service and Southern California Edison. In regards to the latter agreement, Lewinger reminded staff that earlier rate refinement discussions include plans to eliminate Tier 2, which the SCE contract includes.

Colorado River Program Manager Bill Hasencamp reported on the conditions in the Colorado Basin. He said that Lake Powell is dropping by about one-foot per week; at this trend, Lake Powell is expected to be at its lowest level since 2007 by year’s end. Hasencamp also reported that MWD received its 2012 Colorado River Water Diversion Approval. He called attention to the ongoing dispute between IID and MWD over IID’s delivery of non-conserved water to the Salton Sea in 2010 and its under-conservation in 2011. Hasencamp said that the United States Bureau of Reclamation’s (Bureau) showed for the second year in a row that IID’s overrun was larger than its transfer obligation to the Water Authority. Hasencamp also called attention to the fact that 2012 is a benchmark year for both the Colorado River Water Delivery Agreement and the Colorado River Interim Guidelines for Lower Basin Shortages and the Coordinated Operations for Lake Powell and Lake Mead, which allow surplus water be made available to MWD, Southern Nevada Water Authority, and the Central Arizona Project. He said that the Bureau indicated the benchmark would be missed because it included the C2 transfer from IID to MWD that never happened.

Director Record (Eastern) referred to a letter from 17 MWD member agencies addressed to Chairman Foley (see Attachment 3) expressing concern over indications that the IID water transfer to the Water Authority was at “risk of collapse.” Record requested: 1) regular updates related to the transfer, including compliance with QSA requirements, be reported at this or the Executive Committee; 2) that staff provide a dry-year water supply analysis that includes impacts to MWD member agencies resulting from failure of the Water Authority/IID transfer; and 3) that the General Counsel provide a briefing on the Water Authority/IID transfer agreement and opinion on risks to MWD if the agreement were re-opened or terminated.

Subsequently, at the board meeting, Kightlinger acknowledged receiving a letter from IID (IID wrote “the balance of the 2011 conservation shortfall has been satisfied and was ‘paid back’ to the river system, allowing this issue to be fully resolved”) and the Water Authority (see Attachment 4). Kightlinger said while MWD does not agree with IID’s position, MWD appreciated the “cooperative tone” of the letter. He added that staff will brief the board following discussion with the committee chair. Director Steiner added that the Water Authority letter should put to rest speculation of the QSA’s imminent collapse expressed by members of the board. Director Ackerman (Municipal Water District of Orange County) referred to the same member agency letter highlighted earlier by Record and said it is apparent that the adaptive approach illustrated in the Integrated Resources Plan would prepare MWD to meet challenges now and into the future.

Hasencamp also provided an update on a study with Southern Nevada Water Authority, Central Arizona Project, and MWD to fund the monitoring of impacts to the Cienega de Santa Clara, or wetlands of Mexico, by the operation of the Yuma Desalting Plant. The study concluded there were no impacts from the operation of the desalter on the wetlands. The committee also received Bay-Delta and Water Resources Manager’s reports.

**Board Meeting**

The board discussed in closed session the purchase of about 2,175 acres in Riverside and Imperial County. In open session, the board approved authorization the purchase.
Prepared by: Debbie Discar-Espe, Senior Water Resources Specialist
Approved by: Communications and Legislation Committee by Lynne Heidel and Keith Lewinger
Finance and Insurance Committee by Keith Lewinger and Doug Wilson
Engineering and Operations Committee by Fern Steiner
Legal and Claims Committee by Lynne Heidel and Fern Steiner
Organization, Personnel and Technology Committee by Fern Steiner and Doug Wilson
Water Planning and Stewardship Committee by Keith Lewinger and Fern Steiner

Attachment 1: MWD’s July board meeting agendas and Summary of Actions
Attachment 2: Letter on Rate Refinement Discussions, July 9, 2012
Attachment 3: MWD Member Agency Letter, June 22, 2012
REVISED AGENDA

Regular Board Meeting

July 10, 2012

12:00 p.m. -- Board Room

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1. Call to Order
   (a) Invocation: Melinda Snow, Human Resource Analyst, Human Resources Group
   (b) Pledge of Allegiance: Director Doug Wilson

2. Roll Call

3. Determination of a Quorum

4. Opportunity for members of the public to address the Board on matters within the Board's jurisdiction. (As required by Gov. Code § 54954.3(a))

5. OTHER MATTERS
   A. Approval of the Minutes of the Meeting for June 12, 2012. (A copy has been mailed to each Director) Any additions, corrections, or omissions
   B. Report on Directors’ meetings attended at Metropolitan expense for month of June

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MWD Headquarters Building • 700 N. Alameda Street • Los Angeles, CA 90012

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REVISED: Date of Notice: July 5, 2012
C. Presentation of 5-year service pin to Director Robert Wunderlich, representing the City of Beverly Hills

D. Adopt motion to adjourn the August Board Meeting to August 21, 2012 to establish tax rate

E. Approve committee assignments

F. Chairman's Monthly Activity Report

6. DEPARTMENT HEADS' REPORTS

A. General Manager's summary of Metropolitan's activities for the month of June

B. General Counsel’s summary of Legal Department activities for the month of June

C. General Auditor's summary of activities for the month of June

D. Interim Ethics Officer's summary of activities for the month of June

7. CONSENT CALENDAR ITEMS — ACTION

7-1 Appropriate $240,000; and authorize construction of pavement repairs for Service Connection OC-44 and the Santiago Lateral (Approp. 15441). (E&O)

Recommendation:

Option #1:

Adopt the CEQA determination and
  a. Appropriate $240,000;
  b. Authorize replacement of access road paving at Service Connection OC-44; and
  c. Authorize construction of access road paving for the Santiago Lateral pipeline.
7-2  Appropriately $380,000; and authorize two rehabilitation projects at the F. E. Weymouth Water Treatment Plant (Approp. 15477). (E&O)

Recommendation:

Option #1:

Adopt the CEQA determination and
a. Appropriately $380,000;
   b. Authorize preliminary design to rehabilitate the Weymouth treatment basin inlet gates; and
   c. Authorize preliminary design of seismic upgrades to the basin inlet channels.

7-3  Appropriately $1.68 million; and award $1,053,900 construction contract to Dahl, Taylor & Associates to replace the standby generator at the Julian Hinds Pumping Plant (Approp. 15438). (E&O)

Recommendation:

Option #1:

Adopt the CEQA determination and
a. Appropriately $1.68 million; and
   b. Award $1,053,900 contract to Dahl, Taylor & Associates to replace the standby generator at Hinds Pumping Plant.

(END OF CONSENT CALENDAR)

8. OTHER BOARD ITEMS — ACTION

8-1  Authorize payment up to $570,485 for support of the Colorado River Board and the Colorado River Authority of California for fiscal year 2012/13. (WP&S) (Two-thirds vote required)

Recommendation:

Option #1:

Adopt the CEQA determination and, by a two-thirds vote, authorize the General Manager to make payment of up to $570,485 for the CRB/Six Agency Committee and the Authority for FY 2012/13.
8-2 Authorize entering into a water sale agreement with United States Forest Service to provide a maximum of one acre-foot of water per year for drinking and sanitation to the River Gorge Trailhead Project. (WP&S)

Recommendation:

Option #1:

Adopt the CEQA determination and authorize the General Manager to enter into a water sale agreement with United States Forest Service to provide a maximum of one acre-foot of water per year for drinking and sanitation to the River Gorge Trailhead Project.

8-3 Authorize entering into a water sale agreement with Southern California Edison to furnish a maximum of 1,000 acre-feet of supplemental water for its Devers-Palo Verde No. 2 Transmission Line Project Colorado River Substation. (WP&S)

Recommendation:

Option #1:

Adopt the CEQA determination and authorize the General Manager to enter into an agreement with Edison to furnish a maximum of 1,000 acre-feet of supplemental water for its Devers-Palo Verde No. 2 Transmission Line Project Colorado River Substation, on the terms described in Attachment 3 of the board letter.

8-4 Authorize a five-year reimbursable agreement with the California Department of Water Resources to provide services for State Water Project operations and maintenance activities for an amount not to exceed $25 million (including expenditures for subcontracts not to exceed $1.5 million per year). (E&O)

Recommendation:

Option #1:

Adopt the CEQA determination and

a. Authorize a five-year reimbursable agreement with the DWR to provide services for SWP operations and maintenance activities in an amount not to exceed $25 million;
b. Authorize entering into subcontracts greater than $250,000 to complete work under the agreement; and
c. Authorize entering into subcontracts as needed, not to exceed $1.5 million annually under the agreement.
8-5 Authorize staff to proceed with an option to enhance solids handling capability at the Joseph Jensen Water Treatment Plant. (E&O Recommendation:

Option #1:

Adopt the CEQA determination and authorize negotiations with the Los Angeles Department of Water and Power to develop a 50-year use agreement for Metropolitan use of LADWP solids lagoons.

Added 8-6 Authorize the purchase of approximately 2,175 acres in Riverside and Imperial Counties
[Conference with real property negotiators; Riverside County Parcel Nos. 878-250-010, 878-240-023, Imperial County Assessor Parcel Nos. 006-090-022-000, 006-090-030-000, 006-090-032-000, 005-100-002-000, 006-100-001-000, 006-100-006-000, 006-100-012-000, 006-100-014-000, 006-100-017-000, 006-100-019-000; agency negotiators: Gilbert Ivey, Ralph Hicks, and John Clairday; negotiating parties: Gabrych Family Trust (Seller); under negotiation: price and terms; to be heard in closed session pursuant to Gov. Code Section 54956.8]

9. BOARD INFORMATION ITEMS

None

10. FUTURE AGENDA ITEMS

11. ADJOURNMENT

NOTE: At the discretion of the Board, all items appearing on this agenda and all committee agendas, whether or not expressly listed for action, may be deliberated and may be subject to action by the Board.

Each agenda item with a committee designation will be considered and a recommendation may be made by one or more committees prior to consideration and final action by the full Board of Directors. The committee designation appears in parentheses at the end of the description of the agenda item e.g. (E&O, F&I). Committee agendas may be obtained from the Board Executive Secretary.

Writings relating to open session agenda items distributed to Directors less than 72 hours prior to a regular meeting are available for public inspection at Metropolitan's Headquarters Building and on Metropolitan's Web site http://www.mwdh2o.com.

Requests for a disability related modification or accommodation, including auxiliary aids or services, in order to attend or participate in a meeting should be made to the Board Executive Secretary in advance of the meeting to ensure availability of the requested service or accommodation.

REVISED: Date of Notice: July 5, 2012
COMMITTEE ASSIGNMENTS

None. (Agenda Item 5E)

WATER PLANNING AND STEWARDSHIP COMMITTEE

By greater than a two-thirds vote, authorized the payment of up to $570,485 for the Colorado River Board/Six Agency Committee and the Colorado River Authority of California for Fiscal Year 2012/13. (Agenda Item 8-1)

Authorized entering into a water sale agreement with the United States Forest Service to provide a maximum of one acre-foot of water per year for drinking and sanitation to the River Gorge Trailhead Project. (Agenda Item 8-2)

Authorized entering into an agreement with Southern California Edison to furnish a maximum of 1,000 acre-feet of supplemental water for its Devers-Palo Verde No. 2 Transmission Line Project Colorado River Substation, on the terms described in Attachment 3 of the board letter. (Agenda Item 8-3)

ENGINEERING AND OPERATIONS COMMITTEE

Authorized a five-year reimbursable agreement with the California Department of Water Resources to provide services for State Water Project operations and maintenance activities in an amount not to exceed $25 million; entering into subcontracts greater than $250,000 to complete work under the agreement; and entering into subcontracts as needed, not to exceed $1.5 million annually under the agreement. (Agenda Item 8-4)

Authorized negotiations with the Los Angeles Department of Water and Power (LADWP) to develop a 50-year use agreement for Metropolitan use of LADWP solids lagoons. (Agenda Item 8-5)

REAL PROPERTY AND ASSET MANAGEMENT COMMITTEE

Authorized the purchase of approximately 2,175 acres in Riverside and Imperial Counties. (Agenda Item 8-6)
CONSENT CALENDAR

In other action, the Board:

Appropriated $240,000; authorized replacement of access road paving at Service Connection OC-44; and authorized construction of access road paving for the Santiago Lateral pipeline. (Agenda Item 7-1)

Appropriated $380,000; authorized preliminary design to rehabilitate the Weymouth treatment basin inlet gates; and authorized preliminary design of seismic upgrades to the basin inlet channels. (Agenda Item 7-2)

Appropriated $1.68 million; and awarded $1,053,900 contract to Dahl, Taylor & Associates to replace the standby generator at Hinds Pumping Plant. (Agenda Item 7-3)

OTHER ACTION

In other action, the board:

Presented a 5-year service pin to Director Robert Wunderlich, representing the City of Beverly Hills. (Agenda Item 5C)

Adopted motion to adjourn the August Board Meeting to August 21, 2012 to establish the tax rate. (Agenda Item 5D)

THIS INFORMATION SHOULD NOT BE CONSIDERED THE OFFICIAL MINUTES OF THE MEETING.

Board letters related to the items in this summary are generally posted in the Board Letter Archive approximately one week after the board meeting. In order to view them and their attachments, please copy and paste the following into your browser

http://edmsidm.mwdh2o.com/idmweb/home.asp
July 9, 2012

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

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

Dear Mr. Foley:

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

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

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

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

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

Sincerely,

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

cc: Metropolitan Board of Directors

Attachment: LADWP Historic & Projected Water Purchases from MWD
LADWP Historic & Projected Water Purchases from MWD

*Source: MWD Online Operations (1990-2007) and WINS Table A Report (2008-2011)

**Source: LADWP 2010 Urban Water Management Plan
June 22, 2012

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

Dear Chairman Foley:

The purpose of this letter is to reiterate our agencies’ support for your Board’s continued commitment to the implementation of Metropolitan’s Integrated Resources Plan (IRP) and for the on-going defense of Metropolitan’s rate structure which was most recently challenged in another lawsuit brought by the San Diego County Water Authority (SDCWA) on June 8, 2012. As communicated to your Board in our November 25, 2009 letter, we believe the adaptive management strategies in the IRP and Metropolitan’s equitable cost recovery model provide the best methods for southern California to mitigate water supply risk now and in the future in a manner that equitably shares costs and benefits among all Metropolitan’s member agencies. We echo the need for a regionally collaborative approach in light of each Metropolitan member agency’s need to hedge against supply risk, as illustrated below.

With the recent publication of the Los Angeles Economic Development Corporation (LAEDC) report entitled “The Cost of Water in San Diego: The IID Water Transfer and SDCWA Water Rates”, economic data was provided showing that the Imperial irrigation District (IID) transfer has been twice as costly for San Diego County Water Authority (SDCWA) rate payers as purchasing available MWD supplies. Even combining the cost of the IID Transfer and less expensive water from the two canal lining projects (where more than two-thirds of the cost was subsidized by State taxpayers, including taxpayers in our service areas) SDCWA rate payers still paid significantly more than the MWD supply cost.

In 1997 when SDCWA was spurred on to pursue the IID transfer by a local Alliance for Water Reliability headed by Stephen P. Cushman, then President of the San Diego Chamber of Commerce, San Diegan’s were told the transfer would assure San Diego’s “Water Independence”, and in a highly publicized Declaration of Independence on July 3, 1996, declared the proposed transfer would “conserve and transfer up to 300,000 acre feet of water annually to San Diego at a guaranteed price.”

Today, there is evidence that the transfer is not meeting the financial or operational expectations of either SDCWA or IID. This is evidenced in part by the litigation and other aggressive tactics by SDCWA to shift potentially large transfer-related costs onto the State of California and the other MWD member agencies. Issues with the transfer are also illustrated in a comprehensive analysis entitled: “Preliminary Report to IID Board dated December 20, 2011”, which was prepared by Law & Resources Planning Associates and recently presented to the IID Board. This report, which can be found on the IID website, raises substantial financial and operational questions that have direct bearing on the long-term viability of the transfer. The information provided in the report should be of concern to SDCWA rate payers as it suggests, among other things, that the cost of the transfer may escalate even further beyond current projections. Based upon historic cost escalation and uncertainties discussed in the report to the IID Board, it appears that there has not been, and possibly never will be, “a guaranteed price” for the transfer water that is reasonable or affordable.
Mr. John V. Foley, Chairman  
Metropolitan Water District of Southern California  
June 22, 2012  
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Equally troubling are actions that have been taken by IID and SDCWA, including the transfer of water to SDCWA that was not conserved. This appears to be contrary to the terms of the Quantification Settlement Agreement (QSA) whereby only conserved water is eligible for transfer, and raises questions whether the long-term structural conservation needed to fully consummate the transfer is operationally or financially feasible.

As a result of this information, we are coming to the very troubling conclusion that not only is SDCWA’s quest for independence costing far more than their rate payers anticipated, but that the transfer itself appears to be inconsistent with the terms of the QSA and could be subject to collapse. We are further concerned that SDCWA’s carefully orchestrated election-style public relations campaign and its newly filed litigation are designed to divert ratepayers attention in San Diego County away from the high cost and potential unsustainability of the transfer, while attempting to shift the blame and excessive expenses on to Metropolitan and its other member agencies.

Under these circumstances we reiterate our support for Metropolitan’s Integrated Resources Plan (IRP) and its adaptive management approach. We believe that through implementation of the IRP, Metropolitan can prepare southern California for uncertainties such as the potential collapse of the IID/SDCWA transfer, or other unexpected water supply and water quality concerns at the local, regional and state-wide level.

The IRP, with all the deliberation and care that went in to its preparation, has been developed to provide solutions to difficult water supply and water quality challenges. The process is in place, the planning work has been done, and we have the means to provide for the continued water supply reliability of the region at an affordable cost to all, including SDCWA should they need more Metropolitan supplies if the IID water transfer is ultimately infeasible.

We respectfully urge the MWD Board to stay the course in defending against SDCWA’s multiple lawsuits, and to continue to rely upon the IRP and the Long Range Financial Plan processes in place to meet all contingencies, including the possible collapse of the IID/SDCWA water transfer.

Sincerely,

Kevin P. Hunt  
Municipal Water District of Orange County

Richard Nagel  
West Basin Municipal Water District

Paul Jones  
Eastern Municipal Water District

Richard Hansen  
Three Valleys Municipal Water District

James B. McDaniel  
Los Angeles Department of Water and Power

John Rossi  
Western Municipal Water District
Mr. John V. Foley, Chairman
Metropolitan Water District of Southern California
June 22, 2012
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Robert Beste
City of Torrance

John Mundy
Las Virgenes Municipal Water District

Thomas A. Love
Inland Empire Utilities Agency

Peter Kavounas
City of Glendale

Don Calkins
Anaheim Utilities Department

Nabil Saba
City of Santa Ana Public Works Agency

Shane Chapman
Upper San Gabriel Valley Municipal Water District

Gil Borboa
City of Santa Monica

Nina Jazmadarian
Foothill Municipal Water District

Chris Theisen
City of Beverly Hills

William O. Mace, Jr.
City of Burbank
July 10, 2012

Jack Foley and Board Members
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

RE: IID Water Conservation and Related QSA Issues

Dear Mr. Foley:

We wanted to make sure that you and the other Metropolitan board members received a copy of Imperial Irrigation District’s (IID) July 9, 2012 letter to Maureen Stapleton (copied to Mr. Kightlinger) in time for today’s board meeting (Attachment 1). This letter describes the current status of the 2011 water conservation by IID: as of June 30, 2012, the full volume of 80,000 acre feet of water has been conserved. In addition, the letter describes the status of water conservation for 2012, including IID’s projection that its fallowing program will generate over 180,000 acre feet of conserved water for transfer, mitigation and 2011 overrun payback purposes. While we appreciate that there are still accounting issues to be resolved by the Bureau of Reclamation, we hope this letter will put to rest some of the wild speculation by Metropolitan board members that the water transfer or QSA is at the “risk of collapse.”

We have not yet received a response to Ms. Stapleton’s June 27, 2012 letter to Mr. Kightlinger requesting a meeting with Metropolitan pursuant to Section 11.1 of the Exchange Agreement (Attachment 2) and it was not mentioned at yesterday’s Water Planning and Stewardship Committee meeting (Committee). We look forward to receiving a response and to meeting with Metropolitan (and hopefully some of its board members) to address Metropolitan’s concerns. As you know, we have suggested that IID and the Bureau of Reclamation be invited to attend the meeting in order to secure a resolution of the accounting issues – a resolution that the Water Authority fully supports. As you know, neither Metropolitan nor the Water Authority has any independent or unilateral authority to decide these questions.

Metropolitan board members requested at yesterday’s Committee meeting that Metropolitan staff provide more detailed reporting on the status of the QSA and impacts on Metropolitan if it were to fail. We agree on both counts and that providing more detailed reports to the Metropolitan board would be helpful. Water Authority’s past communications have noted that some comments by Metropolitan board members suggest the absence of an understanding that Metropolitan has a contractual obligation of good faith and fair dealing under the Exchange Agreement. Further, some comments reflect a lack of understanding that, but for the availability of this conserved water supply, Metropolitan’s water shortage cutbacks (which ended only little more than one year ago) would have been greater. While it is admittedly a little late to begin this education process, we believe it would help put concerns of our fellow board members to rest.

A public agency providing a safe and reliable water supply to the San Diego region
and that it is in any case, “better late than never.”

Finally, to this same end, we are enclosing another copy of the letter from IID’s attorneys to the Water Authority’s attorneys dated May 1, 2012, providing additional background on the history and accounting issues now pending before the Bureau of Reclamation (Attachment 3). This letter was previously provided to all members of the Metropolitan board of directors along with several other attachments to Ms. Stapleton’s June 27, 2012 letter – but may have been overlooked by some Metropolitan board members in the volume of material that was provided.

In closing, we were informed at yesterday’s Committee meeting that, “we are right back in the drought we were in a few years ago” on the Colorado River. Accordingly, we reiterate the importance of all parties working together cooperatively to support water conservation by IID and the success of the QSA agreements – not just because Metropolitan is contractually bound to do so, but because it’s the right thing to do in order to meet Southern California’s water supply needs in the coming decades.

Finally, when staff brings back a report to the board as requested at yesterday’s Committee meeting, we suggest that you include a full report on the negotiations that Metropolitan has fully participated in, along with the Bureau of Reclamation and the rest of the California parties, for an Alternative Plan to be presented to the State Water Resources Control Board in order to ensure the continued success and implementation of the QSA agreements. Having this kind of information may help put some of our fellow board members at ease.

Sincerely,

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

cc:  Maureen Stapleton
     Jeff Kightlinger
     T. Fulp, USBR
     K. Kelley, IID
     S. Robbins, CVWD
     C. Harris, CRB
     Water Authority Board of Directors

Attachments:
1. July 9, 2012 Letter from IID to SDCWA
2. June 27, 2012 Letter from SDCWA to MWD
3. May 1, 2012 Letter from IID Attorneys to SDCWA Attorneys
July 9, 2012

Maureen Stapleton, General Manager
San Diego County Water Authority
4677 Overland Ave.
San Diego, CA 92123

Dear Ms. Stapleton:

The San Diego County Water Authority has asked the Imperial Irrigation District for a short update regarding two issues: (1) the status of the 16,722 acre-feet IID conservation "shortfall" in 2011, which IID contends was an inadvertent overrun and (2) the approximate scope of the fallowing sign-ups for the 2012-13 IID fallowing program.

The provisional data for the 2011-12 IID fallowing program were originally estimated at 30,134 acre-feet ‘at-farm’ and 32,602 acre-feet ‘at-river,’ with the difference attributed to loss factors such as evaporation and seepage when the at-field values are backed up to IID’s consumptive use accounting location at Imperial Dam.

Based on the finalization of the Bureau of Reclamation’s 2011 decree accounting values, IID determined that the final conservation attributable to its 2011 fallowing efforts was 63,278 acre-feet. The balance of the 80,000 acre-feet of water delivered to SDCWA was under contract in 2011, but wasn’t physically conserved until the January through June 2012 period. As of June 30, 2012, IID has concluded its 2011-12 fallowing program and created the full volume of conserved water associated with this program. Though precise 2012 conservation yields cannot be determined until the first quarter of 2013, IID is confident that the balance of the 2011 conservation shortfall has been satisfied and was ‘paid back’ to the river system, allowing this issue to be fully resolved.

In regard to the 2012-13 fallowing program, IID has been very pleased with sign-ups given the late initiation of this program following the December 2012 appellate decision in the longstanding Quantification Settlement Agreement litigation. IID is still finalizing a few outstanding contracts but anticipates this program will generate over 180,000 acre-feet of conserved water for transfer, mitigation and 2011 overrun payback purposes through June 30, 2013. As we discussed, IID has been aggressively working to increase participation in its fallowing efforts by increasing the payment rate, allowing for early and delayed fallowing start dates to accommodate crop harvests, working with local growers to make agricultural lands owned by IID available for participation in this fallowing program and developing a temporary land conversion fallowing program.
IID staff has already started working on its next fallowing solicitation process, and anticipates kicking this effort off in the late summer/early fall. Staff is also working with local water users to develop new ideas that would add additional flexibility to future fallowing programs, all in an effort to increase participation levels as fallowed water requirements ramp up.

Finally, IID is appreciative of SDCWA's joint participation in the State Water Resources Control Board petition to modify mitigation requirements for the IID/SDCWA transfer. The environmental assessment process is on schedule, as our agencies seek potential approval to eliminate mitigation water to the Salton Sea from 2014 through 2017. If granted, this could also serve to reduce fallowed water requirements for the same period. SWRCB approval of this petition could also allow for resolution of certain water accounting issues with the Bureau of Reclamation that have been outstanding since 2010. It may also allow the California water agencies to focus collaboratively on the continuing issues of accounting banding (schedule flexibility) and constraints on conservation that could be minimized by opportunities such as the expansion of intentionally created surplus conservation measures to include on-farm programs.

If you have any questions, please feel free to call me and thank you for your attention to the above.

Sincerely,

Kevin E. Kelley
General Manager

Copies to:
Terry Fulp, USBR
Steve Hvinden, USBR
Jeff Kightlinger, MWD
Steve Robbins, CVWD
Chris Harris, CRB
Via Email/U.S. Mail

May 1, 2012

Scott S. Slater, Esq.
Brownstein Hyatt Farber Schreck, LLP
PO Drawer 720
Santa Barbara, CA 93102-0720

Re: MWD Letter Of April 12, 2012

Dear Mr. Slater:

The San Diego County Water Authority ("SDCWA") has forwarded to us a letter of April 12 which the Metropolitan Water District of Southern California ("MWD") sent to SDCWA, and has asked us for information related to IID's creation of the conserved water addressed in the letter. We summarize below what we believe are the key facts necessary, from IID's perspective, for SDCWA to consider on the topic of the IID 2011/2012 conserved water. We do not address MWD's claims about SDCWA's alleged duties under its Exchange Agreement with MWD.

Because this letter provides some extensive detail, it may be helpful to first summarize the main points that are presented below:

- MWD's stated concern regarding conservation is that SDCWA received 80,000 acre-feet of water in 2011, through IID's conservation in that actual calendar year turned out to be about 64,000 acre-feet, with the remainder being made up shortly thereafter. However, SDCWA generally receives the contracted water in advance of its creation, with any shortfalls addressed via the IOPP program discussed below. No entity is losing any water as a result.

- MWD is well aware of the important facts around this short-lived deficit. Due to QSA litigation, 80,000 acre-feet of conserved water was placed under contract in 2011, but not all of it could be fully created until early 2012. Given the facts detailed below, this situation was understandable, and should not give rise to controversy.
The Bureau of Reclamation (the "Bureau") was advised of the issue, and still has the matter under review. The QSA framework allows for overrun accounting adjustments, if necessary.

The same parties faced an analogous situation in 2003 and 2004, when water created in 2004 was used for 2003 conservation requirements, and the overrun was handled by the Bureau without formal dispute (the Bureau waived payback for other reasons).

1. Relevant QSA Background Facts

a. QSA Mitigation

IID is implementing the largest efficiency-based water transfer project in the history of the United States, pursuant to the Quantification Settlement Agreement and related contracts (the "QSA and Related Agreements"). The QSA and Related Agreements call for various conserved water transfers from IID. Those transfers cause meaningful environmental impacts in the Imperial Valley region which require mitigation. That mitigation was ordered by the State Water Resources Control Board (the "SWRCB") as a condition of transfer approval. If the mandated mitigation does not occur, then the IID conserved transfers cannot occur.

The funding for QSA mitigation is managed through the QSA Joint Powers Authority ("QSA JPA"), which operates under the QSA JPA Agreement. That QSA JPA Agreement was one of 11 QSA-related contracts (including the QSA itself) voided by a judgment from the Sacramento Superior Court in 2010, with that judgment pending appeal until late 2011, when the judgment was overturned. But for a temporary stay, and then the ultimate appellate decision, the QSA transfers, and all mitigation funding for them under the QSA JPA Agreement, would have been legally prohibited. This was a critical problem for IID and all QSA parties in 2011, as discussed below.

Under the IID-SDCWA transfer agreement, section 6.6, SDCWA has complete discretion as of January 1 of each year as to when to take the scheduled IID transfer water for that year. Thus, for example, if SDCWA were scheduled to receive 80,000 af in a given year, it could take the whole amount in January of that year, even though the conserved water might not actually be created until later in that year. Thus, the transfer is not set up in a manner where the water is created first and then taken later by SDCWA, but rather is structured to allow SDCWA to take the water before it is actually created. Of course, many things could happen later in the year to impede the actual conservation, such as conservation measures which did not work, contract breaches by conserving farmers, or litigation events. If there are shortfalls in the conservation, such could result in overrun events in connection with the Bureau's Colorado River accounting.

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1 Quantification Settlement Agreement Cases (2011) 201 Cal.App.4th 758.
b. IID Conservation And The IOPP

IID is managing water orders of up to 3,100,000 acre-feet annually. Involved in the management of the QSA and Related Agreements are a myriad of variables such as rainfall, salinity, crop changes in response to agricultural commodity markets, maintenance and replacement projects, environmental mitigation requirements, conservation programs, measurement, monitoring and verification, etc.

Because of many such factors, IID cannot always achieve exact conservation targets with precision accuracy. IID's service area contains more than a half-million acres of farmland, thousands of miles of canals and drains and hundreds of control structures, reservoirs, and operational facilities all serving a $1 billion-plus agricultural economic sector that includes hundreds of farming entities and the entire Imperial Valley community.

When the parties contracted under the QSA, MWD and the Bureau knew that the IID would require flexibility in its conservation activities due to the kinds of factors discussed above. The QSA itself specifies that it is premised on the Bureau's Inadvertent Overrun and Payback Policy (the "IOPP") as a "special consideration" in Section 6.2(4). The IOPP references "water conservation measures and operating practices" in the scope of discussion about inadvertent overruns.

IID's consumptive use cap, its "available supply," is determined by its annual diversion less return flow credits, conservation program yields and other authorized reductions. IID submits its water order estimate in advance of the calendar year, and the Bureau approves this order, after the appropriate Part 417 consultation process, with the explicit understanding that water orders submitted in advance of the water year are merely estimates of anticipated water use that may need adjustment throughout the year based on any number of variables. To the extent weather conditions and cropping patterns affect IID's annual water uses and, on occasion, cause inadvertent overruns, the conservation program yields will similarly vary from the values estimated in the initial annual water order. Should IID fail to create the full volume of conserved water anticipated each year, or should its agricultural demands exceed its annual supply, an inadvertent overrun will occur and be subject to the Bureau's payback requirements.

Therefore, the IOPP program allows the Bureau -- and QSA participants -- to have some flexibility as to year-to-year consumptive use of Colorado River water.

2. Key 2011/2012 Facts

As MWD is well aware, IID and all QSA parties faced highly unusual facts and challenges in 2011 that presented them with several QSA implementation issues. The QSA and certain related agreements had been voided by a judgment of the Sacramento Superior Court, with that judgment awaiting an imminent appellate decision. The QSA transfers would have been legally prohibited (absent a stay) upon affirmance of the judgment. While IID had conducted nine successful fallowing programs since 2003, conserved over 700,000 acre-feet of water, and met its scheduled...
transfer and payback requirements (often early)\(^2\), IID foresaw great difficulty in implementing fallowing contracts for its 2011-2012 fallowing program with risk of no mitigation funding caused by the looming appellate decision.

There was a meaningful risk that SWRCB-mandated conservation measures would not be paid if the judgment were affirmed. For IID to conserve water, it not only needs contracts with farmers (discussed below), but also assurance of funding from the QSA JPA for mandated environmental mitigation. If the trial court's judgment were not reversed, the QSA JPA Agreement would be invalid, and thus no mitigation payments could be made pursuant to it, and thus no transfers could occur. At the time of contracting for water in 2011, it was reasonably expected that the stay pending appeal would expire with the appellate decision. If that decision affirmed the trial court, the mitigation funding and transfers would be shut down.

With a July 1, 2011 fallowing program start date (fallowing programs operate on a mid-year-to-mid-year basis to coincide with cropping patterns and farm lease transition dates), IID generally begins its solicitation process at least nine months in advance to accommodate agricultural planning timeframes. Operating under a stay issued in May 2010, the uncertainty associated with the ongoing litigation raised significant concerns regarding IID's ability to transfer any water conserved by fallowing in 2011, or to mitigate the environmental effects of such transfers. IID would not be guaranteed payment for this conserved water or payment for mitigation from the QSA JPA, and its payment obligations to fallowing program participants could not be conditioned upon a valid QSA or the district's receipt of conserved water payments. Additionally, should a fallowing program be interrupted, it was unlikely these fields could be put back into agricultural production in a timely manner due to the limitations of crop planting and farm schedules. Due to the judgment of invalidity risk, IID was therefore unable to continue at full-speed with its usual fallowing program and contracting process, and instead had to resort to an alternate and more deliberate implementation approach.

\(^2\) IID has worked diligently to uphold its contractual commitments, and in fact has often performed earlier than required. To date IID has created and transferred approximately 400,000 acre-feet of conserved water to SDCWA, 40,000 acre-feet to CVWD, over 175,000 acre-feet to the Colorado River system via Exhibit C and other payback obligations, and over 165,000 acre-feet to meet required Salton Sea mitigation obligations. This is in addition to the annual satisfaction of 11,500 acre-feet of miscellaneous PPRs, its 3,100,000 acre-feet consumptive use cap, over 100,000 acre-feet of conservation annually from the IID/MWD program, and the 67,700 acre-feet of conserved water transferred to SDCWA annually via the All-American Canal lining project.
IID delayed initiation of its 2011-2012 fallowing program solicitation and contracting process for as long as possible, all the while hoping for the resolution that an appellate court decision might bring. IID did contract to conserve the full 80,000 acre-feet SDCWA transfer obligation in 2011; however, given the July 1, 2011 - June 30, 2012 fallowing term, approximately 15,800 acre-feet of this fallowing program's conserved water yield (provisionally estimated at 31,600 acre-feet) would be generated in the second half of the current fallowing program (the six-month period from January 1, 2012 through June 30, 2012). This was a prudent and necessary measure to deal with the uncertainty of an appellate result. Enough water was put under contract to meet the obligation to SDCWA, but about half was rolled into 2012, when there might be no payments for mitigation and transfers.

These kinds of difficulties and uncertainties are exactly what the IOPP was designed to address, and indeed the IOPP was used in this manner to deal with a similar situation in 2003 and 2004.

3. **2003/2004 Precedent**

The current situation, where IID will have to conserve some 2011 water in 2012 (water that was already contracted for in 2011), is no different conceptually than the situation in 2003, when IID did not have time to create the annual volume of conserved water for transfer and for Salton Sea mitigation purposes in the remainder of the calendar year after the execution of the QSA in October 2003. IID contracted in 2003 to make up the shortfall in 2004. IID, per its contractual commitments and under the IOPP, makes up the conserved water so that none is lost to the stakeholders or to the Colorado River.

The 2003/2004 scenario was explained in IID General Manager Silva's letter of February 26, 2004 to SDCWA General Manager Maureen Stapleton. A copy of that letter is attached as Exhibit "A." In that letter Mr. Silva stated:

As you know, the California SWRCB did not inform IID and SDCWA of its approval of the Salton Sea mitigation water provision and mitigation schedule until January 7, 2004 (copy attached for your convenience), too late for IID to implement the creation of fallowed Conserved Water in 2003, and for SDCWA to receive the transfer and exchange it with CVWD in 2003. Thus, during calendar year 2004, IID will create 5,000 AF of Conserved Water for 2003 plus 10,000 AF of Conserved Water for 2004, all by falling, and reduce its 2004 diversion from the Colorado River at Imperial Dam, net of return flows, in that combined amount consistent with Sections 3.6(a) and 6.5 of the IID/SDCWA Transfer Agreement, as amended.
The use of 2004 conservation to be applied for 2003 requirements was approved by the Bureau. In its 2004 official accounting document, on page 42 (copy attached as Exhibit "B"), the Bureau showed the 2004 conserved water, and noted its application to the 2003 contractual requirements:

The CRWDA specified required conservation by IID for transfer to SDCWA. The 2004 CRWDA schedule called for 20,000 af conservation by IID for the SDCWA Transfer, and another 10,000 af of conservation by IID for SDCWA Mitigation Transfer. [Because] IID was unable to conserve the SDCWA Mitigation Transfer component of 5,000 af in 2003, this has been added to the 2004 amount.

The Bureau waived the overrun payback for 2003. The math for 2003/2004 is fully shown in IID's annual reports to the State Water Resources Control Board (reports which are sent to MWD, the Bureau, and CVWD each year). Attached as Exhibit "C" are exemplar excerpt pages from that report. You will see that on page 8 of 29, SDCWA received 10,000 af in 2003, yet IID only created 3,445 af by way of fallowing. This resulted in, as stated on this page, an inadvertent overrun of 6,555 af reported by the Bureau, which was then waived by the Bureau, as noted in footnote 2 on the same page:

Since the QSA was executed in October of 2003, IID was able to only fallow 3,445 AF and therefore had an inadvertent overrun of 6,555 AF which was used to satisfy IID's 10,000 AF obligation to SDCWA. The USBR waived payback for 2003 overruns for all Lower Basin entities.

The Bureau is well aware of the 2011/2012 issue as well, and has not made any final determinations. On December 30, 2011, Reclamation sent a letter to IID addressing IID's 2011 diversions. A copy of that letter is attached as Exhibit "D." On the second page of the letter, Bureau Regional Director Ms. Lorri Gray-Lee states:

In 2011, IID notified Reclamation that IID does not expect to conserve the full 80,000 acre-feet necessary to meet the scheduled transfer of Colorado River water to SDCWA in 2011, as set forth in Column 5, Exhibit B, of the CRWDA. The appropriate accounting for this circumstance is under review by Reclamation.

IID believes the issue is still under consideration by the Bureau. Until the 2011/2012 issue is addressed by the Bureau, it seems premature for MWD to claim that it will act preemptively simply on SDCWA's report (page 2 of the MWD April 12 letter to SDCWA).

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3 "Colorado River Accounting and Water Use Report Arizona, California, and Nevada."
Finally, it should be noted that if MWD unilaterally acts, it can create an improper windfall for itself. Per its contract with IID, in 2011 SDCWA took 80,000 af of IID water and delivered such to MWD under the MWD-SDCWA Exchange Agreement. MWD then delivered exchange water in like amount to SDCWA in 2011. If MWD now adjusts SDCWA’s water, and the Bureau charges IID with an overrun, MWD would be getting water twice: both via its threatened adjustment with SDCWA, and by the Bureau cutting IID’s water in 2012 by a like amount, with such water flowing to MWD under the priority schedule. Obviously, this would not be in accord with accepted practice or principles.

4. Conclusion

To the extent you need any further information from IID on the matters addressed above, please let me know. IID desires to do whatever it can to help resolve these issues amicably with all parties.

Very truly yours,

Mark J. Hattam

MJH:hmc
Enclosures

cc: Jeffrey M. Garber, Esq.
    David L. Osias, Esq.