Proposed Staff Recommendation Consent Calendar for February 28, 2013

ADMINISTRATIVE AND FINANCE COMMITTEE

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

   Adopt proposed Supplement to Debt Management Policy – Written procedures to ensure compliance with requirements for Tax Exempt Bonds.

ENGINEERING AND OPERATIONS COMMITTEE

9-  3. Professional services contract with Overland, Pacific & Cutler, Inc. for right of way acquisition as-needed services.
   Authorize the General Manager to award a three-year, as-needed professional services contract, in an amount not-to-exceed $200,000 to Overland, Pacific & Cutler Inc., to provide right of way acquisition services for capital improvement and operating projects through fiscal year 2016.

9-  4. Professional services contract with SAIC Energy Environment & Infrastructure LLC for as-needed construction management support services for the Carlsbad Desalination Water Conveyance Pipeline project.
   Authorize the General Manager to approve Amendment No. 2 to the professional services contract with SAIC Energy Environment & Infrastructure LLC, formerly R.W. Beck, for as-needed construction management support services to support the Carlsbad Desalination Water Conveyance Pipeline project, in an amount not-to-exceed $1.6 million, for a total contract value of $3.6 million.

LEGISLATION, CONSERVATION AND OUTREACH COMMITTEE

9-  5. Sponsorship of Direct Potable Reuse Bill in the State Legislature.
   Modify Board-approved legislative approach to advance direct potable reuse by ensuring that an expert panel and advisory group will provide timely recommendations to the Department of Public Health on the safety of direct potable reuse.

9-  6. Authorize the General Manager to enter into Grant Agreement with the California Department of Water Resources to accept $1,066,725 in Water Conservation Program funding.
   Authorize the General Manager to enter into a two-year agreement with Department of Water Resources for $1,066,725 in grant assistance.
February 28, 2013

Attention: Imported Water Committee

Metropolitan Water District Delegates’ Report (Information)

Background
The MWD committees and board met on February 11 and 12. The next regular MWD board and committee meetings are scheduled for March 11 and 12.

Discussion
This section summarizes discussions held and key decisions made at the February MWD committee and board meetings, as reported by the MWD delegates. The Water Authority delegation supported nine of 11 action items approved by the MWD board. The delegates opposed an item related to MWD awarding new Local Resource Projects (LRPs) subsidies for a water treatment plant. Similar to their past actions related to other recent LRPs, the delegates opposed MWD’s action due to the lack of: demonstrated need for this type of project at MWD; demonstrated benefits to ratepayers other than the recipient agency; and continuing denial of access by the Water Authority’s ratepayers to this type of program (for the Water Authority’s letter to MWD, see Attachment 1). The delegates also opposed an item related to the execution and distribution of the Official Statement (for the Water Authority’s letter to MWD, see Attachment 2). The Water Authority’s delegates requested their letters be entered into the administrative record of the respective committee and board meetings.

Attachment 3 is a copy of MWD’s February board meeting agendas.

Audit and Ethics
The committee received updates on activities in the Audit and Ethics Departments. Staff from the office of the General Auditor reported on the audit findings as it relates to Safety and Environmental Services activities, which was issued with a “less than satisfactory opinion.” The opinion was based on repeated recommendations to improve non-compliance with contractual terms and conditions, out-of-date Health Safety and Manual procedures, and incomplete tracking and internal reporting of releases of hazardous materials and permit information. Staff concluded that immediate action was taken to respond to the findings, improve processes, and prevent regressing back to previous practices.

Communications and Legislation Committee
The committee and board heard a report on the Safe, Clean, and Reliable Drinking Water Supply Act of 2014. Executive Legislative Representative Kathy Cole said that due to concerns raised with the overall size of the proposed $11.14 billion water bond, various legislators are attempting to modify, overhaul or repeal the Water Bond and four bills have been introduced addressing these concerns including SB 36 (Rubio, D-East Bakersfield), SB 40 (Pavley, D-Agoura Hills), SB 42 (Wolk, D-Davis) and AB 142 (Perea, D-Fresno). Cole also summarized MWD staff’s recommended water bond priorities, with the top priority as continued support to fund the State’s share of the public benefits relating to the co-equal goals of water supply reliability and Delta restoration. The priorities also included support of multi-benefit projects that reduce reliance on
imported supplies. Staff plans to return to the board in March with a recommendation to adopt focused water bond priorities and principles to guide staff’s efforts in the modified water bond discussion.

The committee also received reports on state and federal legislative activities. Cole discussed the Governor’s proposed budget released in January; lawmakers have until June to pass a final budget.

**Engineering and Operations Committee**

The committee and board approved six items, including authorizing two new agreements with Southern California Edison Company for the sale of renewable energy from the Red Mountain and Venice Hydroelectric Power Plants, should MWD be awarded with the agreements. On a related issue, implementation of California’s greenhouse gas (GHG) cap-and-trade program, Director Tom Evans (Western) asked staff to return to the committee with a report on MWD’s efforts to purchase power and obtain GHG allowances, which are tradable emissions permits. Director Lewinger requested that staff return with a status report on BrightSource’s proposed solar power plant project on potential land leased from MWD.

**Finance and Insurance Committee**

The committee and board authorized the execution and distribution of an Official Statement related to the sale of bonds. The delegates opposed the item because MWD’s Official Statement continues to inadequately disclose MWD’s potential financial risks, such as the continuation of reduced demands and how this reduction may impact its revenues. Assistant General Counsel Sydney Bennion summarized the Federal Securities Law as it relates to Rule 10b-5 (anti-fraud rule) and Official Statements. Bennion said that MWD is required to meet the anti-fraud standards – and must ensure that the Official Statement is not misleading. However, she said that municipal entities (such as MWD) that issue bonds are exempt from Securities and Exchange Commission (SEC) rules, adding that MWD does not file with the SEC, nor is MWD required to file its prospectus with them. Lewinger asked, and Bennion confirmed that bond counsel prepares the body of the Official Statement, while staff prepares Appendix A with the underwriting team. Bennion added that the financing and legal staff and group managers review the Official Statement for accuracy. Lewinger stated that the Water Authority submitted a letter containing questions about MWD’s rate swap and Appendix A. Chief Financial Officer Gary Breaux said that staff would respond in writing. Subsequent to the board meeting, MWD responded to the Water Authority letter (see Attachment 4).

The committee also received reports on MWD’s investment activity and financial highlights. Breaux said that water sales through January 2013 is tracking about 53,200 acre-feet (af) more than budget; and due to increased water sales (about $36 million) and revenues collected from taxes, readiness-to-serve charges, capacity charges, and power sales (about $9 million), the fiscal year revenues through January are about $45 million more than budgeted. Additionally, Breaux reported that expenses through January are about $121 million less than budgeted, mostly due to lower State Water Contractor costs ($90 million), which Breaux said will likely diminish towards the end of the fiscal year as invoices are paid. Concerned that rates are based on budgeted expenditures not actual costs, Director Wilson reiterated a request for 10 years’ worth of data comparing budget to actual expenditures. General Manager Jeff Kightlinger said that the information may be found in reports already provided by MWD. However, after additional discussion, Breaux agreed to provide the information. Subsequent to the meeting, Breaux gave the
data to Wilson.

**Legal and Claims Committee**
The committee discussed in closed session the litigation with the Water Authority and the *Consolidated Delta Smelt and Salmonid Cases*.

**Organization and Personnel Committee**
The committee received an update on cost saving measures implemented in the Administrative Services Section over the last 10 months. Staff reported an annual cost savings of $875,000 resulting from renegotiated contract pricing, staff reduction, and equipment resizing, to name a few cost saving measures. Director Mudd suggested that a study of MWD’s space utilization and employee workflow be conducted to explore further cost savings opportunities. Chief Administrative Officer Gilbert Ivey responded that MWD is already conducting such a study.

**Water Planning and Stewardship**
The committee and board approved two items, including an item related to Water SMART grant funding that may be awarded by the Bureau of Reclamation. Lewinger made a motion to amend staff’s recommendation to specifically state that the disbursement of the grant funds shall not be subject to “rate structure integrity” (RSI) provisions, as described in the board memo but not stated in the recommendation. Water Resources Manager Deven Upadhyay responded that similar grants received in the past were made available to all member agencies in MWD’s service area; and Kightlinger recommended the committee not modify staff’s recommendation based on the fact that staff believes that all grant funds are distributed equitably with or without RSI provisions. Lewinger’s motion failed due to a lack of a second; and staff’s recommendation was approved.

The committee received a report on MWD’s Water Surplus and Drought Management Plan and Bay-Delta matters. Staff reported that imported supplies and storage reserves remain the same as last month. Staff provided an update on fish restrictions affecting the SWP deliveries. Due to a confluence of events, Delta pumps have been operated in the more restrictive mode and, as of February 8, 2013, the combined export loss (deliveries curtailed) for the SWP and Central Valley Project contractors was 735,000 af for 2013.

The committee also received reports on Colorado River matters and Water Resources Management. Colorado River Manager Bill Hasencamp said that the month of January continued to be dry in the Colorado River Basin. If the dry conditions continue, it is possible that Lake Powell would reach the “Mid-elevation Release Tier,” which was established in the Interim Shortage Guidelines. This would result in the Upper Basin (Lake Powell) releasing less water (from 8.23 maf to 7.48 maf) to the Lower Basin (Lake Mead), hastening the decline of Lake Mead’s elevation and increasing the chances of a declaration of shortage in the Lower Basin. In response to Director Edwards (Foothill), Hasencamp said that if shortage were to be declared in 2015, MWD would continue to have access to its stored water from its Desert Water Agency and the Coachella Valley Water District account; however, MWD’s access to water stored in Lake Mead (Drop 2 and Yuma Desalter water) is unclear. Hasencamp added every 10-feet drop in Lake Powell results in $1 million loss in power supply; however, over the years, MWD has not purchased supplemental power because Lake Mead provided sufficient power supply to pump MWD’s entire Colorado River allotment. Director Record (Eastern) asked the status of Imperial
Irrigation District’s efforts on restoring the Salton Sea; Kightlinger responded that staff’s understanding of the issue is based on “what is printed in the newspapers.”

For future agenda items, Upadhyay indicated that staff plans to return to the committee with a report on the development of a new local storage program based on five principles adopted by the board in November 2011.

**Board Meeting**
Directors Michael Touhey (Upper San Gabriel Valley), Robert Apodaca (Central Basin), and Leticia Vasquez (Central Basin) were inducted to the Board of Directors.

Prepared by: Debbie Discar-Espe, Senior Water Resources Specialist
Approved by: Audit and Ethics Committee by Doug Wilson.
Communications and Legislation Committee by Keith Lewinger and Vincent Mudd
Finance and Insurance Committee by Keith Lewinger and Doug Wilson
Engineering and Operations Committee by Fern Steiner
Legal and Claims Committee by Vincent Mudd and Fern Steiner
Organization, Personnel and Technology Committee by Doug Wilson
Special Committee on Bay Delta by Fern Steiner
Water Planning and Stewardship Committee by Keith Lewinger and Fern Steiner

Attachment 3: MWD’s Board meeting agenda and Summary of Actions, February 2013.
February 11, 2013

John V. Foley, Chairman, and
Members, Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

Re: Board Item 7-4 – OPPOSE
Authorize entering into a Local Resources Program agreement with Calleguas Municipal Water District and Camrosa Water District for the Round Mountain Water Treatment Plant

Dear Mr. Foley and Members of the Board:

The Water Authority’s delegates OPPOSE Board Item 7-4 on the following grounds.

Under California law, including Proposition 26, Metropolitan Water District (MWD) is required to set water rates that do not exceed the reasonable and proportionate costs of providing the particular service for which the rate is charged, and that are equitable, fair and non-discriminatory. MWD has failed to present in Board Memo 7-4, by reference to its materially outdated 2007 Local Resources Plan (LRP) “goal,” or otherwise, any showing that MWD’s payments for this local water supply project will benefit any ratepayers other than those who will, through the implementation of this project, cease being customers of MWD and thus no longer be required to pay its water rates and charges. The bare assertion in Board Memo 7-4 that MWD’s payment of these local water supply costs “benefit all member agencies regardless of individual project location,” is not substantiated by any evidence and is untrue. There is no demonstration that any water supply or transportation costs are, or will be avoided by MWD as a result of these payments.

MWD’s continued payment of subsidies under current conditions harms all remaining MWD ratepayers by further reducing already-depressed demand for MWD water. It reduces MWD’s own revenues and further drives up the cost of water purchased by other customers of MWD member agencies. The fact that MWD’s imported water sales are declining as a result of water conservation and the development of local projects by its member agencies is not the problem – the problem is that MWD refuses to make planning adjustments and fundamental changes to its finances to acknowledge its reduced sales; indeed, in the face of these monumental changes, MWD continues to increase spending including paying some of its member agencies.
and other local water suppliers to buy less of its imported water supplies.

Although MWD recently updated its Official Statement to reflect reduced demands by hundreds of thousands of acre-feet annually, it has NOT made the same adjustment to its IRP or the local resources development “goal” which is the purported basis of this staff recommendation. If MWD updated its IRP and LRP “goal” to be consistent with the information it has now disclosed in its Official Statement, it would be clear that there is no justification – let alone legally required justification – for MWD to pay for this and other local water supply projects. MWD is intentionally choosing to rely on outdated, incorrect and unreasonable water supply and financial planning estimates to justify the shifting of costs between and among member agencies in a manner that is entirely inconsistent with cost of service requirements of California’s Constitution, statutes and common law.

Last December, the Water Authority provided MWD a list compiled from MWD member agencies’ Urban Water Management Plans showing the potential to develop up to 1.2 million acre-feet of local water supply throughout Southern California, including 415,000 acre-feet of planned projects and nearly 800,000 acre-feet of potential projects. We noted then and repeat now that MWD has incorporated only 103,000 acre-feet of these supplies in its Regional Urban Water Management Plan as an offset to demands on MWD.

Following the adoption of the 2010 IRP, staff reported that The Brattle Group was retained to recalibrate MWD’s MWD-MAIN demand forecast model given the substantially changed conditions since the model was last recalibrated. Although the board was informed that staff would present a report on the new data last June, no board memo or report has ever been presented. But while this information has not been brought forward to the board, and although MWD suspended its “Local Resource Development Task Force” many months ago in order to reexamine the merits of the program and the water demand projections it is based on, staff continues to bring projects forward for board approval based on the planning documents it knows full well are incorrect.

In addition to these grounds, the Water Authority objects to being charged a “Water Stewardship Rate” (WSR) to pay for this project because its ratepayers have been barred by the MWD board’s August 2010 action from receiving any WSR benefits. Accordingly, the WSR is discriminatory, violates California law and may not be collected from the Water Authority’s customers.

As part of the lawsuit it has filed challenging MWD’s 2013 and 2014 water rates, the Water Authority is seeking to be relieved of any financial responsibility for this and other WSR projects approved by the MWD board of directors, so that the agencies that do not object may pay for these projects. As stated many times, the Water Authority has no objection if other MWD agencies wish to “pool” their money in such a manner, however, that activity must be
Mr. Foley and Members of the Board  
February 11, 2013  
Page 3

voluntary and not part of the water rates imposed by MWD on the ratepayers of all of its member agencies.

Sincerely,

Keith Lewinger  
Director

Vincent Mudd  
Director

Fern Steiner  
Director

Doug Wilson  
Director

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

Attachment 1: Water Authority letter dated December 10, 2012 Re Board Item 7-1  
Attachment 2: The Multifaceted Cost of Water, Frank Royer (October 2009)  
Attachment 3: The Rising Cost of Imported Water, Gene West (November 2008)  
Attachment 4: One More Step Towards Self-Reliance, Tim Hoag (Winter 2011)  
Attachment 5: California State Auditor Report titled, Southeastern Los Angeles County: Various Reasons Affect the Rates Water Suppliers Charge and the Rate Increases They Have Imposed (January 2013 Report 2012-104)

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\[a\] Although the board adopted an Integrated Resources Plan (IRP) update in 2010 that specifically articulated the plan’s “adaptive management” objective, the board memo fails to even reference that document and instead refers to the even more dated 2007 LRP “goal.”

\[b\] It is unclear from the information provided in the board report how much, if any, water the Camrosa Water District has ever purchased from MWD. Attachment 2, page 30 of 53 of board memo states: “During the late 1930’s though 1979, Camarillo State Hospital, with a patient population of nearly 1000, relied exclusively upon water from a perched aquifer located at the base of the Conejo Hills, outside the boundaries of the Pleasant Valley Basin. The water provided for extensive irrigation needs of the 634-acre site, and potable supplies to the hospital and onsite residential area. In 1979, the state contracted with Camrosa Water District to supply water to the site when state mandated water quality standards became difficult to meet. The supply has not been used regularly in the interim.” (emphasis added) Thus, this situation may present an even more extraordinary diversion from cost-of-service principles than was presented, for example, with regard to the Cal Poly Pomona water treatment plant approved by the MWD board in December 2012 (See Attachment 1, Water Authority letter dated December 10, 2012). There, the supporting documentation made clear that the primary objective of the applicant was to protect its own customers against future cost increases by MWD (see Attachment 1, endnote I at page 3). In this
case, MWD is at worst, funding a local water supply project for an agency that may never have paid any MWD water rates and charges. At best, Camrosa is similar to the Cal Poly Pomona case, with its “Water Self Reliance, the Sooner the Better” program which targets local water supply development in order to avoid future rate increases imposed by imported water suppliers (see Attachment 2, The Multifaceted Cost of Water, by Frank Royer, General Manager (October 2009)). “Camrosa is nearing completion of a master plan to develop local resources to combat the rising cost of imported water.” See also Attachment 3, The Rising Cost of Imported Water, by Gene West, Camrosa Board of Directors (November 2008). Ironically – given that MWD’s ratepayers are being asked to pay for Camrosa’s water treatment plant, the same article boasts that Camrosa customers were not impacted by MWD’s 15% water supply reduction, due to the extent of its own local water supply development. Finally, see Attachment 4, One More Step Towards Self-Reliance, by Tim Hoag, Camrosa Board of Directors (Winter 2011), discussing the water treatment plant MWD is proposing to fund and stressing that it will “permanently lower [Camrosa’s] dependence” on imported water.

To be clear, the Water Authority does not question the motives or wisdom of Camrosa’s management and board of directors. To the contrary, the Water Authority has the same objectives – to purchase less imported water and protect our ratepayers from future rate increases associated with imported water. But the question presented is why the Water Authority’s ratepayers should pay more by underwriting MWD subsidies so that Camrosa ratepayers may, permanently, pay less.

The California State Auditor recently released a Report titled, Southeastern Los Angeles County: Various Reasons Affect the Rates Water Suppliers Charge and the Rate Increases They Have Imposed (January 2013 Report 2012-104) (Attachment 5 to this letter). In stark contrast to MWD’s 2007 Local Resources Plan (or outdated Integrated Resources Plan – which as noted above is not even cited as a basis to justify payment of these local agency project costs – the State Auditor found that, “MWD’s sales of treated water, which make up over half of its total water sales, declined by more than 328,000 acre-feet, or 25 percent, from fiscal years 2007-08 through 2011-12, from 1.3 million acre-feet to almost 981,000 acre-feet. MWD’s total water sales also decreased 20 percent over the same period.”
December 10, 2012

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

Re: Board Item 7-1 – OPPOSE
Authorize entering into a Local Resources Program agreement with Three Valleys Municipal Water District and California State Polytechnic University, Pomona, for the Cal Poly Pomona Water Treatment Plant

Dear Mr. Foley and Members of the Board,

The Water Authority’s delegates OPPOSE Board Item 7-1 on the following grounds.

Under California law including Proposition 26, Metropolitan Water District (MWD) is required to set water rates that do not exceed the reasonable and proportionate costs of providing the particular service for which the rate is charged, and that are equitable, fair and non-discriminatory. MWD has failed to present in Board Memo 7-1, by reference to its outdated Integrated Resources Plan (IRP), even more outdated 2007 Local Resources Plan (LRP) “target” or otherwise, any showing that MWD’s payments for this local water supply project will benefit any ratepayers other than those who will, through the implementation of this project, virtually cease being customers of MWD and thus no longer be required to pay its water rates and charges.¹ There is no demonstration that any water supply or transportation costs are or will be avoided by MWD as a result of these payments. The assertion in Board Memo 7-1 that MWD’s payment of the local water supply costs of certain member agencies and ratepayers “benefit all member agencies regardless of individual project location,” is not substantiated by any evidence and is in fact, untrue.

Far from benefitting ratepayers of other member agencies, MWD’s payment of subsidies under current conditions actually harms all remaining MWD ratepayers by further reducing already-depressed demand for MWD water. This in turn reduces MWD’s own revenues and further drives up the cost of water purchased by other customers of MWD member agencies. The problem, of course, is not that MWD’s imported water sales are declining – water conservation and local projects are a good thing – but rather, that MWD refuses to make planning adjustments to acknowledge its reduced sales and, indeed, continues to

¹ There is no demonstration that any water supply or transportation costs are or will be avoided by MWD as a result of these payments.
increase spending.

Although MWD recently updated its Official Statement to reflect reduced demands by hundreds of thousands of acre-feet annually, it has NOT made the same adjustment to its IRP or local resources development “target,” which is the purported basis of this staff recommendation. If MWD updated its IRP and LRP target to be consistent with the information it has now disclosed in its Official Statement, the justification to pay for this and other local water supply projects would be completely eliminated.

MWD’s expenditures have exceeded its revenues in five out the past eight years because water sales are down by more than 30% since the 2007 LRP “target” for local resources development and 2010 IRP were adopted. Rather than respond to these changed circumstances (consistent with the IRP’s articulated “adaptive management”), MWD is intentionally choosing to rely on outdated water supply and financial planning that assume water demands that do not exist and are not reasonably projected to exist in the foreseeable future.

The Water Authority recently compiled a list showing the potential to develop up to 1.2 million acre-feet of local water supply throughout Southern California, including 415,000 acre-feet of planned projects and nearly 800,000 acre-feet of potential projects identified in MWD member agencies’ Urban Water Management Plans. A copy of this summary is attached. And yet, MWD has incorporated only 103,000 acre-feet of these supplies in its Regional Urban Water Management Plan as an offset to demands on MWD. MWD is artificially inflating the demand for MWD’s imported water in order to justify its 2007 LRP subsidies “target” for local water supply development.

MWD staff’s recommendation to approve this subsidy agreement is also inconsistent with its own actions many months ago to suspend its “Local Resource Development Task Force” in order to reexamine the merits of the program and the water demand projections upon which it is based.

In addition to these grounds, the Water Authority objects to being charged a “Water Stewardship Rate” (WSR) to pay for this project because its ratepayers have been barred by the MWD board’s August 2010 action from receiving any WSR benefits. Accordingly, the WSR is discriminatory, violates California law and may not be collected from the Water Authority’s customers.

As part of the lawsuit it has filed challenging MWD’s 2013 and 2014 water rates, the Water Authority is seeking to be relieved of any financial responsibility for this and other WSR projects approved by the MWD board of directors, so that the agencies that do not object may pay for these projects. As stated previously, the Water Authority has no objection if
other MWD agencies wish to “pool” their money, however, that activity must be voluntary and not part of the water rates imposed by MWD on the ratepayers of all of its member agencies.

Sincerely,

Keith Lewinger
Director

Vincent Mudd
Director

Fern Steiner
Director

Doug Wilson
Director

Attachment

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

1 Attachment 2, page 44 of 112, states that, “California State Polytechnic University – Pomona (CSUP) annual water usage over the last 10 years is approximately 504 AF/year. Over the same time period CSUP receives approximately 269 AF/year potable water supply from Three Valleys Municipal Water District (District). This supply is primarily made up of imported water purchased by the District from Metropolitan Water District of Southern California (MWD). The reliability and cost of this imported water has been significantly impacted by a combination of drought conditions and environmental constraints primarily from the State Water Delta issues.” Thus, after implementation of the project – estimated to produce up to 250 acre-feet per year – CSUP would be purchasing 19 acre-feet of water annually from MWD, thus protecting its own customers against future cost increases by MWD.
Southern California’s Local Water Supply Development Plans (2012 - 2035)

Up to 1.2 Million Acre-Feet
Does not include 650,000 AF of planned and state-mandated conservation.

Estimated On Line Date
- Green: 2012 - 2015
- Blue: 2016 - 2020
- Orange: 2021+
- Black: Projects completed in two phases

County Boundaries
MWD Member Agency Boundaries

San Diego County Water Authority
sdcwa.org 4677 Overland Ave. • San Diego, California • 92123-1233
<table>
<thead>
<tr>
<th>County</th>
<th>Water Agency</th>
<th>Project</th>
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<td>IRWD Wells 51, 52, 53, 21 &amp; 22 Potable</td>
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<td>Riverside</td>
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<td>Eastern Regional Reclaimed Water System</td>
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<td>EMWD Indirect Potable Reuse</td>
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<td>Perris Desalter</td>
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<td>Western Municipal Water District</td>
<td>Chino Basin Desalter 3</td>
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<td>Western Municipal Water District</td>
<td>Rancho California Reclamation</td>
<td>13,800</td>
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<td>Arlington Basin Groundwater Desalter Project</td>
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<td></td>
<td>Various</td>
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<td>1,125</td>
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<td>San Bernardino</td>
<td>Inland Empire Utilities Agency</td>
<td>Chino Basin Desalter 2</td>
<td>11,760</td>
<td>2016</td>
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<td></td>
<td>Inland Empire Utilities Agency</td>
<td>Carbon Canyon/IEUA Regional Recycled Water Distribution System</td>
<td>25,000 - 50,000</td>
<td>2015 - 2020</td>
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<td>San Diego</td>
<td>Oceanside</td>
<td>Mission Basin Desalter</td>
<td>5,600</td>
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<td>Otay Water District</td>
<td>Rosarito Beach Desalination</td>
<td>28,000</td>
<td>After 2020</td>
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<td></td>
<td>San Diego County Water Authority</td>
<td>Water Purification Project</td>
<td>16,800 - 89,600</td>
<td>2020 - 2035</td>
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<td>San Diego County Water Authority</td>
<td>Carlsbad - Seawater Desalination Project</td>
<td>56,000</td>
<td>2020</td>
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<td></td>
<td>Sweetwater Authority</td>
<td>Reynolds Desalination Facility Phase II</td>
<td>5,200</td>
<td>2020</td>
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<td></td>
<td>Various</td>
<td>Projects under 5,000 acre-feet combined</td>
<td>32,962</td>
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<td>Ventura</td>
<td>Calleguas Municipal Water District</td>
<td>Oxnard GREAT Program</td>
<td>15,500</td>
<td>2016</td>
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<td></td>
<td>Calleguas Municipal Water District</td>
<td>Camrosa Santa Rosa Basin Desalter</td>
<td>5,040</td>
<td>2020</td>
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<td>Calleguas Municipal Water District</td>
<td>South Las Posas Desalter</td>
<td>5,000</td>
<td>2020</td>
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<tr>
<td></td>
<td>Various</td>
<td>Projects under 5,000 acre-feet combined</td>
<td>11,018</td>
<td>2012 - 2025+</td>
</tr>
</tbody>
</table>
After hearing of actions being taken by neighboring water purveyors to restrict water use, many Camrosa customers have called to ask whether Camrosa implemented mandatory water restrictions. While Camrosa is subject to the same 15% reduction in its imported water allocation, we have so far been able to use our diverse water portfolio to avoid issuing restrictions. Our customers significantly reduced their water consumption in July and August and we continue to rely upon you to make good decisions about conserving water.

While necessary in the short run, water conservation alone will not solve the water crisis. The use of recycled water for irrigation must become commonplace in order for us to live comfortably amidst dwindling imported water supplies and periods of drought. We must make the capital investment necessary to reduce our dependence upon imported water. As the cost of imported water continues to rise, water reuse projects will help maintain our lifestyle while keeping the cost of water affordable in the years to come.

The rates will be going up again in January. The vast majority of the cost increase is due to the double-digit increases instituted by our imported water suppliers — increases that Camrosa has no choice but to pass onto our customers. Increases, too, must cover infrastructure maintenance as well as system expansion. It is critical to upgrade aging infrastructure before it fails and to look to the future with construction of new infrastructure that will, in the long run, reduce Camrosa’s reliance on imported water.

Camrosa is nearing completion of a master plan to develop local resources to combat the rising cost of imported water. Capital replacement and building new, non-potable water infrastructure are critical components of the plan. Financing this capital investment is part of the multifaceted cost of water and will continue to be reflected in our pricing structure. For more information, see the related article on the front of this newsletter.

New Camrosa Website Launched
Check out our new website for information about our portfolio of water resources, Board of Directors, customer service, water conservation tips, Camrosa’s on-going efforts to build self-reliance and more!

Leisure Village Wins National WaterReuse Award
Leisure Village’s conversion of its irrigation system to recycled water has gained the recognition of the national WaterReuse Association, who named Leisure Village as one of six winners of their Award of Merit. The project will save more than 550 acre-feet of imported drinking water at a considerable cost savings to Leisure Village and will make our drinking water supplies more reliable for all Camrosa customers.

Free California Friendly Landscaping Class
Join us on Saturday, 10/17 from 9A – 1P to learn how to create a beautiful garden with water-wise plants! Enrollment is limited, so call 482-8514 to reserve your place in the class.
Join Camrosa and our local water agency partners in our cooperative efforts to reduce reliance on expensive imported water.

October '09

Water Reuse as a Solution

Recycled Water Expansion – Past, Present and Future

For years, Camrosa has been a leader in water recycling in Ventura County and has sought to build the infrastructure necessary to bring recycled water to all areas of the District.

To date, Camrosa has embarked upon an ambitious five-phase plan to build the necessary infrastructure to reduce our heavy reliance upon imported water head-on and to develop a sustainable water future.

The Sooner the Better

Water Self-Reliance

Camrosa Water

INDEPENDENT

attachment11.png
The cost of imported drinking water delivery to Camrosa will increase significantly starting in January 2009. With California officially in a drought and the water supply from Northern California being cut by 30% last January, competing demands for available supplies are driving prices up.

Reserves Drawn Down to Unprecedented Levels

Even as many California water agencies implement mandatory restrictions, reservoirs are being drawn down. According to the Association of California Water Agencies (ACWA), the state’s major reservoirs are at about one-third of capacity at a time when they would typically be at two-thirds. Lake Oroville, one of the Northern California reservoirs where 82% of Camrosa’s drinking water originates, is at less than one-third of its capacity.1

ACWA Executive Director Timothy Quinn said, “We are in a tough situation, but our problems won’t go away when it starts raining again.”

Working Toward Long-Term Solutions

While we have no control over the escalating cost of imported water, Camrosa and its local water agency partners have a long-term plan for development of local resources. We look forward to sharing more details on the specific projects in future issues of the Camrosa Water Independent.
Join Camrosa and our local water agency partners in our cooperative efforts to reduce reliance on expensive imported water.

Another Drop About Recycled Water

Camrosa Water District
7385 Santa Rosa Road
Camarillo, CA 93012-9284

Camrosa Water Independent

attachment1Page13.png
As our customers work to conserve water under the Metropolitan Water District’s mandated 15% reduction, Camrosa continues to look for ways to permanently lower our dependence on imported water. Camrosa has recently rehabilitated an abandoned and previously unusable well to tap into a brackish groundwater. The next step is to construct a desalination facility (desalter) to bring the water up to drinking water quality. Engineering is underway and, when complete, the desalter will provide an additional 1,000 acre-feet of locally produced potable water to Camrosa’s customers.

This project not only builds self-reliance by expanding upon the use of local water sources, the project is an integral part of a regional water management program designed to transport salts off the Calleguas Creek Watershed and improve local groundwater quality. Camrosa’s desalter will be the first desalting facility to discharge the salts removed from the treated water to a Regional Salinity Management Pipeline (SMP) now under construction by Calleguas MWD. Collectively, the desalter facility and the SMP will help solve a groundwater quality challenge along with improving local self-reliance.

Imported Water Savings and More
While the most obvious benefit of the proposed desalter is the improved water reliability that comes with production of up to 1,000 acre-feet of potable water, environmental benefits will include:
- Reduced reliance upon imported state water transported from the Sacramento Bay Delta
- Improved local groundwater quality from removal and transport of salts out of the Watershed
- Enhanced overall quality of local aquifers by making storage available for higher quality natural runoff that now flows to the ocean
- Reduced energy consumption and greenhouse gas emissions as a result of eliminating the need to lift water over the Tehachapi Mountains into Southern California

Conservation Still Part of the Equation
Camrosa is committed to our long-term goal of reducing demand for imported water and to stabilizing the reliability and cost of our water supply. We ask you to keep in mind that we are still under a mandated 15% reduction in our imported water allocation. As the weather cools off this season, please reduce the amount of water used to irrigate your lawn. Also, as your appliances age and need to be replaced, consider water efficiency when making purchasing choices. (See the related article on front panel.)
How Much Water Can You Save Indoors?

Indoor Water Use Best Practices

<table>
<thead>
<tr>
<th>Activity</th>
<th>Water Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Run only full loads in the clothes washing machine.</td>
<td>15-20 gallons per load</td>
</tr>
<tr>
<td>Select a high-efficiency clothes washer when replacing old machine.*</td>
<td>20-30 gallons per load</td>
</tr>
<tr>
<td>When washing dishes by hand, use less detergent. Use a spray device or short blasts instead of letting the water run.</td>
<td>2.5 gallons per minute</td>
</tr>
<tr>
<td>Run only full loads in the dishwasher.</td>
<td>2-4.5 gallons per load</td>
</tr>
<tr>
<td>Turn off water when brushing teeth or shaving.</td>
<td>10-15 gallons a day</td>
</tr>
<tr>
<td>Install low-flow shower heads.</td>
<td>2.5 gallons</td>
</tr>
<tr>
<td>Take 5 minute showers instead of 10 minute showers.</td>
<td>12.5 gallons with low flow showerhead</td>
</tr>
<tr>
<td>Plus, place a bucket in the shower while bathing and use the overflow for watering plants!</td>
<td>25 gallons with standard 5.0 gallon per minute showerhead</td>
</tr>
</tbody>
</table>

*Rebates start at $135 (for washers purchased on or after 6/1/10). Statewide rebates of $100 - Starting 4/22/10. It may be possible to combine SoCal WaterSmart rebates with statewide appliance rebates to further leverage your new appliance investment. (See www.SoCalWaterSmart.com.)

Sources: Water-Use it Wisely; Bewaterwise.com

Water Savings

- 15-20 gallons per load
- 20-30 gallons per load
- 2.5 gallons per minute
- 2-4.5 gallons per load
- 10-15 gallons a day
- 2.5 gallons
- 12.5 gallons with low flow showerhead
- 25 gallons with standard 5.0 gallon per minute showerhead

“Water is Life” Art Contest

Students from Santa Rosa Magnet and Tierra Linda Elementary participated in the “Water is Life” art contest earlier this year. Students’ artwork portrays indoor and outdoor water waste and ways to change our habits to conserve water. The top students’ artwork is displayed at Camrosa’s office for viewing. CONGRATULATIONS to our winners!

1st Place: Kimberly Bolt – 3rd Grade (Mrs. Nealon, Tierra Linda Elementary)
2nd Place: Sammi Stout – 2nd Grade (Mrs. Wells, Santa Rosa Tech. Magnet School)
3rd Place: Brennan Rodnick – 2nd Grade (Mrs. Wells, Santa Rosa Tech. Magnet School)
4th Place: Marcus Braun – 3rd Grade (Mrs. Nealon, Tierra Linda Elementary)
5th Place: Melia Prince – 2nd Grade (Mrs. Wells, Santa Rosa Tech. Magnet School)

Source: Camrosa Water District
Southeastern Los Angeles County

Various Reasons Affect the Rates Water Suppliers Charge and the Rate Increases They Have Imposed

January 2013 Report 2012-104
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For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.
January 29, 2013

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor (state auditor) presents this audit report concerning the cost of water delivery in southeastern Los Angeles County. This report concludes that various reasons affect water rates and why these rates have increased. Such reasons include water suppliers budgeting for increasing costs to purchase water or to make capital improvements to their water treatment facilities or other infrastructure. In other cases, certain suppliers have increased their water rates because they stopped using reserve funds to help lower consumer water rates or have wanted to promote water conservation by increasing the cost for a given amount of water.

In general, water suppliers set their water rates in a manner to recover their anticipated costs for the upcoming fiscal year. As water flows to consumers in southeastern Los Angeles County, various entities play a role in its management and, as a result, contribute costs that are ultimately passed on to consumers. A significant portion of the water used in Los Angeles is imported from outside the county and is distributed by the Metropolitan Water District of Southern California (MWD), the regional wholesaler. MWD’s water rates are expected to increase by 75 percent from 2008 to 2014. Key factors that drive MWD’s water rate increases are its increasing budget for capital improvements—such as improving its water treatment facilities—and the higher costs of purchasing imported water through the State Water Project.

Our review also found that local wholesalers and retailers have faced increasing costs for various reasons. The Central and West Basin municipal water districts—the two local wholesalers we reviewed—have roughly doubled their water rates during the past five years. Budget documents at both wholesalers revealed that they have been facing increasing costs to finance and build infrastructure to provide recycled water to their customers and thus rely less on imported water. Similarly, water retailers we reviewed have planned for additional costs to make improvements to their infrastructure while also using higher prices as a means to promote conservation.

Despite the water rate increases, we found that mechanisms exist for the public to provide input into rate increases, including the transparency of proposed actions and the ability to use the electoral process if not satisfied with specific outcomes, but such mechanisms could be more effective. Our review noted that the city of Los Angeles recently began using an independent ratepayer advocate to consider water rate increases proposed by the Los Angeles Department of Water and Power before higher rates are approved by the city council. Depending on the effectiveness of this advocacy, the Legislature may want to consider requiring all publicly operated water suppliers to use a similar ratepayer advocate.

Respectfully submitted,

ELAINE M. HOWLE, CPA
State Auditor
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Southeastern
Los Angeles County

Various Reasons Affect the Rates Water Suppliers Charge and the Rate Increases They Have Imposed

January 2013 Report 2012-104
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Summary

Results in Brief

In July 2008 a family of four living in southeastern Los Angeles County could have purchased 20 units of water—about a month’s supply—from the City of Downey Department of Public Works (Downey) for $23.48. As of July 1, 2012, that same family of four would pay $38.57, or 64 percent more than it did in 2008. If the same family lived elsewhere, it could have purchased an equal amount of water from the City of Los Angeles Department of Water and Power (LADWP) for $60.64 in 2008 but $84.05—or 39 percent more—as of July 1, 2012. The purpose of our audit was, in part, to examine why water rate increases have occurred since 2008 and why the price for buying the same quantity of water from different suppliers can vary significantly.

As part of our audit of water suppliers in southeastern Los Angeles County, we identified the different types of agencies involved in supplying water to consumers (for example, the regional wholesaler, local wholesalers, and retailers), and we examined the rates suppliers charged and the reasons for any significant year-to-year rate increases. We also identified the processes suppliers used to approve proposed rate increases, the mechanisms in place to help ensure that consumers are protected from unreasonable rate increases, and the impact on water rates attributable to specific categories of expenses, such as litigation and administration.

Several reasons contributed to increases in water suppliers’ rates in effect on July 1 of each year from 2008 through 2012. Chief among these is that the suppliers’ costs increased. Because suppliers base the rates they charge on the amount of annual revenue they believe is necessary to cover their annual water-related costs, when costs increase, so do rates. For instance, one retailer—LADWP—budgeted a cost increase of $47.7 million, or 26 percent, from fiscal years 2008–09 to 2012–13 for the cost of purchased water. According to LADWP’s water executive managing engineer, the increase in the cost of purchased water was caused by increases in the water rates charged by the Metropolitan Water District of Southern California, the regional wholesaler. Other reasons suppliers cited for rate increases include improving water conservation by implementing tiered rate structures in which

Audit Highlights . . .

Our audit of water suppliers in southeastern Los Angeles County highlighted the following:

» Water suppliers attributed rate increases to the increasing cost of purchasing water, improving water conservation, and no longer relying on reserves to help cover annual costs.

» We questioned the legality of almost $1 million in fee revenues that the city of Downey transferred from its Water Fund because it could not sufficiently substantiate that the funds were used for water-related purposes.

» Because a consumer’s physical location determines the retailer that will provide water, there is a lack of competition and consumers cannot select among retailers to obtain the lowest rate.

» We found that spending at each of the seven water suppliers was generally consistent with their respective policies and procedures and seemed reasonable.

---

1 We defined southeastern Los Angeles County as the area roughly bounded by Highway 72 on the north, the Orange County line on the southeast, the Pacific Ocean on the south, and Highway 110 on the west.

2 A unit of water is 100 cubic feet, or approximately 748 gallons.
customers pay higher per-unit rates when their water usage exceeds certain levels, and no longer relying on reserves to help cover the annual costs of providing water.

When examining water rates, we observed that portions of Downey’s water rates may not be allowable under the California Constitution. Because Downey could not substantiate that almost $1 million in revenues that it transferred from its Water Fund to other funds were actually for specific water-related purposes, we question whether these transfers comply with the provisions of Article XIII D of the California Constitution, added by Proposition 218 in 1996. Under these provisions, revenues derived from a fee or charge cannot exceed the funds required to provide the service, revenues cannot be used for purposes other than those for which the fee or charge was imposed, and the local agency imposing the fee bears the burden of proving the fee complies with the article. We found that during fiscal years 2007–08 through 2010–11, Downey transferred almost $1 million from its Water Fund to other funds. Although Downey staff told us that the transfers to the Sewer and Storm Drain Fund paid for costs incurred by the stormwater engineering division, they were unable to provide sufficiently detailed evidence to convince us that the transfers were for water-related purposes. Our legal counsel advised us that court decisions interpreting Article XIII D have not prohibited local governments from charging its customer water fees that would recoup the costs of the government’s water department on other departments, as long as these fees reasonably represent such costs. Because Downey did not provide evidence sufficient to make such a conclusion, we questioned the legality of these transfers.

We also identified several mechanisms that exist to help ensure that consumers are protected from unreasonable rate increases. Because a consumer’s physical location determines the one retailer that will provide water, the lack of competition means that the consumer cannot choose among retailers to obtain the lowest rate. The mechanisms protecting against unjustifiable rates include transparency, the electoral process, and the use of consumer advocates. To provide transparency, government-operated suppliers consider water rates and proposed rate increases at public hearings or meetings held by their governing boards. The public has the right to attend and participate in these meetings or hearings and can voice opinions about proposed rate increases. Also if consumers do not like the decisions made by public water agencies, they can use the electoral process to replace members of their governing boards. Finally, two entities—the California Public Utilities Commission (CPUC) and LADWP—use consumer advocate positions to independently analyze proposed rate increases.
When faced with increasing water rates, some customers may blame poor spending decisions by water suppliers—for instance, spending on litigation involving other water suppliers, administrative overhead, or other factors—or more direct costs, such as maintenance or the treatment necessary to make water drinkable. Our review of 141 transactions at the seven water suppliers we examined revealed that spending was generally consistent with the water suppliers’ policies and procedures and seemed reasonable. We also found that legal and administrative expenses constituted relatively modest proportions of the overall costs for the seven water suppliers, and that the suppliers typically maintained approximately six months’ to a year’s worth of operating costs in reserves.

Recommendations

To ensure that it can meet the burden of proof that its water fees comply with Article XIII D of the California Constitution, Downey should be able to provide, upon request, documentation that all transfers out of the Water Fund are for water-related purposes. Such documentation should be sufficiently detailed and understandable to the layperson.

If it believes that the mechanisms available to consumers in southeastern Los Angeles County to protect against unreasonable rates or rate increases are not sufficient, the Legislature should consider enacting additional consumer protection mechanisms. Mechanisms to consider include ratepayer advocacy positions similar to those used by the CPUC and LADWP.

Agency Comments

Downey did not agree with our finding and its response did not address how it would implement the recommendation we made to it.
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Introduction

Background

Different entities, including different types of water suppliers, are involved in the water delivery system serving southeastern Los Angeles County. Figure 1 on the following page summarizes this delivery system. Retail water suppliers provide water directly to consumers. Retailers include both investor-owned companies and government entities, such as cities. If it is available, retailers can get their water by extracting it from underground by using wells. Retailers can also buy water imported from outside Los Angeles County. We focused most of our audit work on three retail water suppliers—the City of Los Angeles Department of Water and Power (LADWP), the City of Downey Department of Public Works (Downey), and the Golden State Water Company (Golden State Water).

Local wholesalers, the second type of water supplier, sell imported water to those retailers whose groundwater supplies are not sufficient to meet customer demand and who do not have direct access to imported water. To help minimize the use of imported water, local wholesalers can also sell recycled water to retailers for landscaping and other uses. Local wholesalers are government entities, such as municipal water districts. Our audit focused on the Central Basin Municipal Water District (Central Basin District) and the West Basin Municipal Water District (West Basin District). The West Basin District was created in 1947 and the Central Basin District in 1952 to provide additional water supplies to retailers to supplement groundwater sources. Each of these two local wholesalers is governed by its own five-member board of directors elected by the public from its service area. Figure 2 on page 7 shows the respective service areas for the Central Basin District and West Basin District.

The third type of water supplier, the regional wholesaler, provides imported water to local wholesalers and to certain retailers. The regional wholesaler for southeastern Los Angeles County is the Metropolitan Water District of Southern California (MWD), which is a government agency. MWD was created in 1928 to develop, store, and distribute water to Southern California. Its mission is to “provide its service area with adequate and reliable supplies of high-quality water to meet present and future needs in an environmentally and economically responsible way.” Through an infrastructure that includes five treatment plants, 242 miles of canals, and 819 miles of pipeline, MWD imports water into Southern California for resale to its 26 members. MWD members include retailers and local wholesalers and consist of 14 cities, 11 municipal water districts, and one county water authority. Currently, a 37-member board of directors governs MWD. Each member agency has at least one member on the board, while larger suppliers, as determined by assessed property values within a member agency’s district, may have more. MWD acquires the imported water it supplies from two main sources: Northern California, via the State Water Project’s California Aqueduct, and the Colorado River, via the Colorado River Aqueduct. MWD can provide either treated or untreated water to its member agencies.
Figure 1
Water Delivery System for Southeastern Los Angeles County

Sources: Urban water management plans for the entities named or other documents the entities provided.

* All local wholesalers do not have access to desalted water.
† Members of the Metropolitan Water District of Southern California (MWD).
‡ The city of Los Angeles operates its own recycling program.
§ All retailers do not have access to surface water.
II The Water Replenishment District of Southern California purchases water from various sources to recharge the groundwater basins beneath southern Los Angeles County.
# Nonmembers of the MWD.
Sources: Web sites for the Water Replenishment District of Southern California (replenishment district), the Central Basin Municipal Water District (Central Basin District), and the West Basin Municipal Water District (West Basin District).

--- = Service area for the replenishment district.

Besides water suppliers, other entities also play roles in southeastern Los Angeles County’s water delivery system. One such entity is the Water Replenishment District of Southern California (replenishment district). The replenishment district was formed in 1959 to replenish and maintain the Central and West Coast groundwater basins by
purchasing imported and recycled water, recharging\textsuperscript{4} the basins, and halting seawater intrusion.\textsuperscript{5} The mission of the replenishment district is “to provide, protect and preserve high-quality groundwater through innovative, cost-effective and environmentally sensitive basin management practices for the benefit of residents and businesses of the Central and West Coast Basins.” To accomplish its mission, the replenishment district purchases imported and recycled water from several sources to replenish the Central and West Coast groundwater basins and for injection into barriers to help prevent seawater intrusion into the groundwater basins. To help cover its costs, the replenishment district collects an assessment for each acre-foot of water pumped from its service area. Figure 2 shows the replenishment district’s service area, which generally includes the areas overlaying the Central and West Coast groundwater basins.

The rates that consumers pay to retailers help cover the costs of the different water agencies along the water supply chain. However, each retailer pays different proportions of its rate to the other water agencies. Based on the rates that the regional wholesaler, local wholesalers, retailers, and replenishment district charge their customers, and based on the proportions of imported water and groundwater used by each of the three retailers we examined, we estimated the proportions of the water rates paid by consumers that go to other water agencies. Each retailer obtains its water using a different supply route. Golden State Water relies on a mix of groundwater and imported water to meet its demand and obtains its imported water from local wholesalers. LADWP also relies on a mix of groundwater and imported water but obtains its imported water directly from MWD and via its own aqueducts. Downey relies entirely on groundwater to meet its potable needs.

Figure 3 shows that the proportion paid to the replenishment district varies among the retailers we examined, and the proportion of the retailers’ rates that goes to local wholesalers is relatively small. For example, 56 cents, or 52 percent, of Downey’s $1.08 rate per unit\textsuperscript{6} would go to the replenishment district. In comparison, 32 cents (8 percent) of Golden State Water’s rate would go to the replenishment district, and only 1 cent, or 0.1 percent, of LADWP’s rate would go to the replenishment district. For LADWP, the percentage is small because only a small proportion of the water that LADWP provides to its customers within the replenishment district’s service area is groundwater. Also, the combined costs that Golden State Water pays to local wholesalers is only 10 cents, or 3 percent of its rate, even though 43 percent of its water comes from local wholesalers.

\textsuperscript{4} According to the replenishment district, recharging involves putting water back into a groundwater basin via manual methods such as injection or percolation (placing freshwater on the ground and allowing it to seep into the basin). Recharging is used when natural replenishment (for example, percolation from storm runoff or inflow from other basins) is not sufficient to replace groundwater that is removed from the basins.

\textsuperscript{5} Seawater can enter groundwater basins near the coast when levels of groundwater drop below a certain point.

\textsuperscript{6} A unit of water is 100 cubic feet, or approximately 748 gallons.
Figure 3
Estimated Portions of Retailer Rates That Cover the Costs of Other Agencies

Sources: California State Auditor’s estimation based on water supply data provided by the California Department of Water Resources, water retailers’ rate sheets, and water retailers’ internal water reports.

Notes: Various entities play a role in providing water to the residents of Los Angeles County or ensuring such water continues to be readily available. Depending on the source of water, different entities are involved and their costs are ultimately passed on to consumers. The amounts shown in the figure represent an estimation of the relative proportion of a retailer’s water rate that is attributable to other entities besides the water retailer. To perform the estimation, we began with each water retailer’s total volumetric rate for its Tier 1 water. For example, LADWP’s Tier 1 rate for June 1, 2012, was $3.63 per hundred cubic feet. We then estimated what portion of that $3.63 water rate was attributable to MWD and to the replenishment district based on the amount of imported water from MWD and groundwater from the replenishment district’s service area LADWP obtained, and the applicable rates charged by those entities respectively. The amounts shown only consider the volumetric cost of water and do not consider additional fixed costs imposed by the various water agencies involved.
Another entity involved in southeastern Los Angeles County’s water delivery system is the California Public Utilities Commission (CPUC), a state agency. The CPUC is responsible for the regulation and oversight of Golden State Water and other investor-owned utility companies in California. Large investor-owned water utilities (10,000 water service connections or more) are required to submit a formal application every three years with the CPUC for consideration and approval before implementing rate changes. The CPUC rate-setting process is an adversarial process in which the investor-owned water utility submits evidence and makes its case for higher rates before an administrative law judge. Representing consumers, the CPUC’s Division of Ratepayer Advocates reviews the evidence and challenges the utility’s justification for the rate increases. The CPUC rate-setting process also includes public participation hearings in the affected local jurisdictions so that consumers can participate. Ultimately, the administrative law judge makes a recommendation to the commissioners of the CPUC as to whether the water rates should be increased, and the CPUC commissioners make the final decision. According to Golden State Water’s vice president, these rate-setting cases can take as long as 18 months to complete and they include thousands of pages of evidence.

The service areas for Los Angeles County’s numerous water retailers can be confusing, as geographic or political boundaries are not always reliable indicators of which retailer supplies water to a particular address (the physical location receiving the water determines which retailer provides water services). In some areas of southeastern Los Angeles County, neighbors living across the street from each other can have different water retailers. For example, according to Downey’s utilities manager, depending on their location, consumers in the city of Downey will be served by one of three retailers: Downey, the city of Santa Fe Springs, or Golden State Water. Also, according to the city of Bellflower’s Web site, consumers will purchase their water from one of four retailers: the Bellflower Municipal Water System, the Bellflower-Somerset Mutual Water System, the Bellflower Home Garden Water Company, or the Park Water Company (Park Water).

Conversely, the same retail suppliers can provide water to different areas of the county. For example, according to its Urban Water Management Plans, Golden State Water provides water to all or portions of numerous cities in Los Angeles County, including Artesia, Bell, Bell Gardens, Carson, Cerritos, Compton, Cudahy, Downey, Hawaiian Gardens, Huntington Park, Lakewood,

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7 The California Department of Water Resources requires each of the State’s urban water suppliers to submit an Urban Water Management Plan every five years to assess the reliability of its water sources over a 20-year planning horizon given different possible scenarios. The department requires this plan to ensure that supplies are available to meet existing and future water demands.
La Mirada, Long Beach, Norwalk, Santa Fe Springs, South Gate, and Vernon. Further, according to its Urban Water Management Plans, Park Water provides water to portions of six cities in southeastern Los Angeles County: Artesia, Bellflower, Compton, Lynnwood, Norwalk, and Santa Fe Springs. Both companies also provide water to portions of unincorporated Los Angeles County.

**Water Sources and Costs**

As Figure 1 on page 6 shows, consumers in southeastern Los Angeles County buy their water through water retailers. When local water sources are not sufficient to meet demand, retailers must acquire water imported from outside Los Angeles County. Retailers buying MWD’s imported water to meet consumer demand will acquire that water through one of two supply routes. If the retailer is an MWD member, it can buy imported water directly from MWD. If the retailer is not an MWD member, it can buy MWD’s imported water through a local wholesaler that is an MWD member. LADWP is a unique retailer in that it imports its own water from Northern California via the Los Angeles Aqueducts to help meet customer demand. However, LADWP still relies on MWD’s imported water to meet a significant portion of its needs.

Figure 1 also shows that local water sources include groundwater, recycled water, and desalted water. Recycled water, sometimes called reclaimed water, essentially is sewer water that has been sufficiently treated to make it usable for certain nonpotable purposes, such as landscape irrigation.

Groundwater can be less expensive than imported water. For instance, retailers purchasing treated imported water in 2012 from local wholesalers paid $915 (Central Basin District) or $1,036 (West Basin District) per acre-foot. In contrast, a water supplier that pumped groundwater out of the Central or West Coast basin paid the replenishment district an assessment of $244 per acre-foot. If well operation and maintenance costs were $200 per acre-foot, the total cost of groundwater would be $444 per acre-foot, or $471 less than imported water purchased from the Central Basin District and $592 less than imported water purchased from the West Basin District.

**Court Judgments Related to Groundwater**

Courts have set limits on the amount of groundwater that entities such as retailers can pump from the Central and West Coast groundwater basins. According to the California Department of

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8 An acre-foot of water is approximately 325,800 gallons.
Water Resources (Water Resources), in the early 1900s, increases in industry and agriculture caused demand for groundwater to exceed the basins’ natural replenishment. This overpumping led several entities to file suit to set groundwater rights for the West Coast Basin, resulting in a court judgment that limited pumping from that basin in 1961. Other entities similarly filed suit to set their rights to groundwater from the Central Basin, resulting in a separate judgment in 1965 that set restrictions on pumping groundwater from that basin.

To assist the courts in the administration and enforcement of their judgments, each court appointed Water Resources as watermaster. To help Water Resources track the amount of groundwater extracted, pumpers, which includes retailers, report amounts pumped monthly. Water Resources tracks the monthly amounts pumped throughout the fiscal year and calculates the amounts that pumpers can legally pump during the remainder of that fiscal year.

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) directed the California State Auditor (state auditor) to perform an audit to evaluate the cost of water delivery in southeastern Los Angeles County. Specifically, the audit committee directed the state auditor to focus on the significant factors that contribute to a water customer’s bill to identify the reasons for the rising cost of water, as well as methods to improve the cost-effectiveness of water delivery. The audit analysis the audit committee approved contained six separate objectives. We list the objectives and the methods we used to address them in Table 1.

Table 1
Audit Objectives and the Methods Used to Address Them

<table>
<thead>
<tr>
<th>AUDIT OBJECTIVE</th>
<th>METHOD</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.</td>
<td>With the assistance of legal counsel, we reviewed provisions of the California Constitution, state statutes and regulations, and judicial decisions relevant to water suppliers and the California Public Utilities Commission (CPUC). We also reviewed local charters and codes.</td>
</tr>
<tr>
<td>2 Identify the roles—related to the delivery and sale of water in Southern California—of the Metropolitan Water District of Southern California (MWD), the Water Replenishment District of Southern California (replenishment district), wholesale water suppliers (such as the Central Basin Municipal Water District [Central Basin District]), and retail water suppliers.</td>
<td>We interviewed key staff and obtained documentary evidence, such as annual budget documents and mission statements, to understand the roles of these organizations and where they fit into the water supply chain for Los Angeles County.</td>
</tr>
<tr>
<td>3 Identify the regulatory role of the CPUC with respect to overseeing the rates set by the area’s privately owned water suppliers.</td>
<td>We interviewed staff from the CPUC and reviewed the state statutes that establish the CPUC’s authority and powers. Further, we reviewed documents submitted to the CPUC for certain rate cases.</td>
</tr>
<tr>
<td>AUDIT OBJECTIVE</td>
<td>METHOD</td>
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</tbody>
</table>
| 4 Select two wholesale water suppliers (the Central Basin District and another wholesale water supplier that receives water from the MWD) and three retail water suppliers that supply water to Los Angeles County. To the extent possible, for each water wholesaler and retailer selected: | • In addition to the Central Basin District, which was specifically identified in the audit request, we selected the West Basin Municipal Water District (West Basin District) based on the geographic size of its service area and our judgment regarding the needs of our report’s users.  
|                                                                               | • After considering the size, water sources, ownership type (that is, government operated or investor owned), and other information, we selected the City of Los Angeles Department of Water and Power (LADWP), the City of Downey Department of Public Works (Downey), and the Golden State Water Company (Golden State Water) as the retail water suppliers for review. |
|                                                                               | a. Review and evaluate the process and basis each water supplier uses for establishing its water rates.                                                                                              | • Because some water suppliers have different rates for different classes of water, we focused our review on single-family residential rates because we thought these rates would be the most meaningful to our report’s users.  
|                                                                               |                                                                                                                                         | • For the three wholesalers and three retailers we examined, we reviewed budget and accounting documents to understand how increasing costs drove the need for a rate increase. We also identified the extent to which the public was informed of the rate increases and whether the public was afforded an opportunity to provide input into proposed rate changes. |
|                                                                               | b. Identify the significant factors that contribute to the water rates each supplier charges its respective customers and any major differences in water rates charged by each water supplier. | • We established different consumer usage levels and determined the water bills paid by consumers purchasing each of the amounts of water from each of the three retailers we reviewed.  
|                                                                               |                                                                                                                                         | • We reviewed budget documents that water providers used when increasing their rates to better understand what costs have a significant effect on water rates and the extent to which these costs have increased over time. |
|                                                                               | c. Review and assess any changes in rates over the most recent five-year period and the reasons for any major changes in the water rates.       | • For the water suppliers we selected, we identified, documented, and summarized the water rates charged and rate structures in effect on July 1 for 2008 through 2012.  
|                                                                               |                                                                                                                                         | • We identified and documented changes in water rates over the audit period and examined certain major changes to determine whether suppliers sufficiently justified them. |
|                                                                               | d. Review a sample of expenditures over the last five years, including expenditures for infrastructure projects, bonds, and general operations. Determine whether those expenditures were allowable and reasonable. | • We reviewed 141 transactions—at least 15 per water supplier—and determined the reasonableness of the transaction. In general, our review of transactions involved determining whether the expenses were consistent with suppliers’ internal policies and procedures.  
|                                                                               |                                                                                                                                         | • We judgmentally selected the 141 expenditures instead of selecting a random sample because we assessed varying levels of risk both among the different water suppliers and among their respective spending accounts. In selecting transactions for testing, we chose expenditures based on a number of factors, including dollar amount, risk level, and any reported concerns of inappropriate spending. Because we judgmentally selected items for testing, the results of our testing cannot be projected to the population of transactions from the water suppliers. |
|                                                                               | e. Examine any increases in each water supplier’s respective administrative costs and reserve amounts over the last five years. Identify the reasons for any major increases and whether they were reasonable and necessary. | Based on our review of budget documents and other accounting records, we reviewed each of the five water suppliers’ administrative costs and reserve amounts for fiscal years 2007–08 through 2011–12. If administrative costs or reserve amounts had increased significantly, we interviewed key staff to understand the reasons for these increases. Finally, for water suppliers that maintained large unrestricted reserve amounts, we inquired as to the planned uses for those unrestricted reserves. |
## AUDIT OBJECTIVE

<table>
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<tr>
<th>Objective</th>
<th>Method</th>
</tr>
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<tr>
<td>5 Identify any best practices for streamlining and making water delivery more cost-effective for the residents in Los Angeles County.</td>
<td>During our review of the water suppliers and their policies, we looked for practices that promoted greater transparency or accountability to the public for proposed water rate increases. We also looked for instances in which water suppliers had instituted policies that minimized the effects of rate changes. We identified no such best practices. According to the manual <em>Principles of Water Rates, Fees and Charges</em>, 6th edition, 2012, published by the American Water Works Association, different rules for formulating water rates exist that are based on local conditions and requirements. These varying conditions allow each supplier to determine a unique set of practices that cannot always be applied to other water suppliers.</td>
</tr>
<tr>
<td>6 Review and assess any other issues that are significant to the cost and delivery of water to Los Angeles County residents and businesses.</td>
<td>No other issues came to our attention.</td>
</tr>
</tbody>
</table>

**Sources:** California State Auditor’s analysis of Joint Legislative Audit Committee audit request number 2012-104, planning documents, and analysis of information and documentation identified in the column titled *Method*.

In performing audit work at the water suppliers and the CPUC, we obtained numerous financial records, budget documents, and other evidence that were generated from computer-processed data maintained by the eight auditees that were included in our audit. The U.S. Government Accountability Office, whose standards we follow, requires us to determine whether we need to test the effectiveness of the auditees’ information system controls in order to obtain sufficient and appropriate evidence for our conclusions. In our judgment, we did not need to test these information system controls for the purpose of answering the audit objectives. The audit objectives focused on explaining water suppliers’ justification and rationale for their rate increases, not whether water suppliers had reliable cost data with which to reach their conclusions. As a result, we make no conclusions in our audit report regarding the accuracy of these financial data. When presenting budget and cost information in our report, we disclose that these are unaudited data so as not to mislead our report’s users.
Audit Results

Different Reasons Contribute to Water Rate Increases Among Wholesalers and Retailers

As part of our audit, we examined the rates water suppliers had in effect on July 1 of each year from 2008 through 2012. Suppliers we examined included:

- The regional wholesale supplier—the Metropolitan Water District of Southern California (MWD).
- Two local wholesale suppliers—the Central Basin Municipal Water District (Central Basin District) and the West Basin Municipal Water District (West Basin District).
- Three retail suppliers—the City of Los Angeles Department of Water and Power (LADWP), the City of Downey Department of Public Works (Downey), and the Golden State Water Company (Golden State Water).

We also examined the rates charged by the Water Replenishment District of Southern California (replenishment district).

Specifically, we identified increases in the rates each entity charged and determined why significant increases occurred from one year to the next. Although we identified several reasons for these rate increases, the most prevalent one was that the suppliers’ own costs increased. Because suppliers base the rates they charge on the amount of annual revenue they believe necessary to cover their annual costs, when costs increase, so do rates. For example, LADWP rates for 20 units of water increased 39 percent from July 2008 through July 2012, while the cost of the water it buys from MWD increased by 26 percent and the interest expense pertaining to capital-related debt increased by 69 percent from fiscal years 2008–09 to 2012–13. Other reasons for rate increases included improving water conservation by implementing a tiered rate structure in which those consumers who use more water pay higher rates, and eliminating deficits when annual revenues are not sufficient to cover the costs of providing water.

The Regional Wholesaler’s Rates Have Increased Since 2008 Due to Increased Costs and Lower Water Sales

As we mentioned in the Introduction, MWD is the regional wholesaler for southeastern Los Angeles County. Since fiscal year 2007–08, MWD’s water rates and costs have increased, even as water sales have declined. The rates MWD charges for
its water generate sufficient revenue from water sales to cover most of its costs.\textsuperscript{9} The Tier 1 rate is MWD’s rate for a certain amount of water; deliveries beyond this amount are charged at a higher Tier 2 rate. As shown in Figure 4, MWD incrementally increased its Tier 1 rate for treated water from $508 per acre-foot as of January 1, 2008, to $794 per acre-foot as of January 1, 2012, or by 56 percent over this period. MWD’s Tier 1 rate increased an additional $53 per acre-foot on January 1, 2013, and it will increase a further $43 per acre-foot on January 1, 2014.

MWD’s sales of treated water, which make up over half of its total water sales, declined by more than 328,000 acre-feet, or 25 percent, from fiscal years 2007–08 through 2011–12, from 1.3 million acre-feet to almost 981,000 acre-feet. MWD’s total water sales also decreased 20 percent over the same period. As we elaborate later, economic and weather conditions affect MWD’s water sales.

\textbf{Figure 4}

\textbf{Metropolitan Water District of Southern California’s Rate for Full-Service, Treated Water 2008 Through 2014}

Source: Metropolitan Water District of Southern California’s (MWD) approved water rates.

Note: MWD provides water to its member agencies for a variety of purposes, ranging from fully treated water for drinking purposes to untreated water for other purposes, including treatment by member agencies and groundwater replenishment. The amounts shown in the figure pertain only to MWD’s full-service, treated Tier 1 water deliveries, which includes drinking water. Deliveries of water beyond a certain amount are charged at a higher Tier 2 rate not shown in the figure. MWD also imposes additional fixed charges not reflected in the figure.

\textsuperscript{*} MWD Tier 1 water rates are generally effective January 1 of each year, but the 2010 rate went into effect on September 1, 2009.

\textsuperscript{9} When designing its different water rates and charges for fiscal year 2011–12, MWD planned to recover $1.51 billion, or 90 percent, of its total $1.68 billion in expected costs. MWD planned to obtain the remaining $168 million from property taxes, hydroelectric power sales, and other miscellaneous income.
MWD’s four largest cost areas, as seen in Figure 5, relate to the State Water Project, capital financing, operations and maintenance, and supply program costs. These four cost components constitute approximately 90 percent of MWD’s total costs and together increased by $356.4 million, from $1.15 billion in fiscal year 2007–08 to $1.51 billion in fiscal year 2011–12.

Figure 5
Metropolitan Water District’s Estimated Costs Used to Determine Water Rates Fiscal Years 2007–08 Through 2011–12

Sources: Metropolitan Water District of Southern California (MWD) cost-of-service studies.
Note: We did not audit these amounts.
* Colorado River Aqueduct costs incorporate power costs associated with pumping water from the Colorado River.
† The reserves amount reflects reserve fund transfers required by bond covenants and the MWD’s administrative code.
‡ Water management program costs reflect payments made to member agencies in support of local resource development and active conservation efforts.
§ Supply program costs reflect the costs of entering into agreements with water agencies to store and transfer water to MWD to augment deliveries from the State Water Project and the Colorado River Aqueduct.
¶ Operations and maintenance costs include, among other things, labor and benefit costs; chemical, electricity, and sludge disposal costs incurred in the water treatment process; costs for operating equipment; and professional service payments to outside consultants for specialized skills.
# Capital financing program costs include debt service and capital expenditures funded from revenues or reserves to finance MWD’s capital projects.
** State Water Project costs reflect MWD’s allocable portions of the costs associated with the State Water Project system, as well as variable power costs associated with pumping water from the system.

MWD’s budget for its capital financing costs had the largest increase, as measured in dollars, during the five-year period we reviewed. These budgeted costs increased by $133.8 million (37 percent), from $364 million in fiscal year 2007–08
to $497.8 million in fiscal year 2011–12. According to MWD documents, one reason for the increase is significant capital improvements at MWD's five water treatment plants. Some of these improvements were necessary to ensure that treated water continues to meet regulatory standards.

MWD is also pursuing other capital improvement projects to maintain its infrastructure. For example, MWD has active projects aimed at rehabilitating or replacing aging equipment at pumping plants, upgrading electrical and power systems at water treatment plants, and constructing a new pipeline from a treatment plant to the boundary of a member agency. Further, as the owner and operator of the 242-mile Colorado River Aqueduct, MWD must perform ongoing maintenance on equipment that pumps water over mountainous terrain, lifting it by a total of approximately 1,600 feet. Budget documents indicate that MWD's infrastructure expenditures are expected to grow as more facilities reach the end of their service life.

Another major area of MWD cost increases is the State Water Project. MWD is one of 29 water suppliers that have long-term contracts with the State for the State Water Project, a system to provide water throughout much of California. MWD is the State Water Project's largest contractor and is allocated approximately 46 percent of the State Water Project's total amount of water allocated to contractors in any given year. Under the terms of its contract with the State, MWD is obligated to pay certain allocated expenses associated with the operation, maintenance, power, and replacement cost of the State Water Project's transportation facilities through at least the year 2035, regardless of the quantities of water available. This means that MWD is required to pay these costs even if it obtains no water.

MWD's budgeted costs related to the State Water Project increased by $86.1 million (20 percent), from $431 million in fiscal year 2007–08 to $517.1 million in fiscal year 2011–12. The State Water Project is operated by the California Department of Water Resources (Water Resources), which we did not audit. A program manager in MWD's budget and financial planning section stated that Water Resources is identifying and undertaking significant repair and rehabilitation projects on the State Water Project. According to MWD documents, some of the increase was used to finance the environmental and preliminary engineering for the long-term infrastructure necessary to improve reliability in the Sacramento-San Joaquin River Delta, along with actions to help address concerns regarding endangered species in the delta. Water Resources bills its contractors, including MWD, for their share of the costs associated with the State Water Project. However, MWD engages an independent auditor annually to audit the charges that
Water Resources submits to MWD, to ensure that the amounts charged to MWD are correct. This audit was performed for every year we examined, and MWD’s auditor determined that the statements of charges submitted to MWD by Water Resources were fairly presented in all material respects in each year.

Another major source of MWD’s costs is expenditures related to its water supply programs. MWD’s water supply programs increase the availability and reliable delivery of water throughout MWD’s service area. The manager of MWD’s Water Resource Management Group stated that the costs of the water supply programs are incurred when MWD enters into agreements with other water agencies to store and transfer water to MWD. This water can then be used to augment other water deliveries from the State Water Project and Colorado River Aqueduct. Budgeted supply programs costs paid by operating revenues increased by $90.1 million (311 percent), from $29 million in fiscal year 2007–08 to $119.1 million in fiscal year 2011–12. The largest increase occurred from fiscal years 2007–08 to 2008–09, when supply programs costs increased by $110.4 million (381 percent). According to MWD, this increase was due to the substantial costs of additional water transfers\(^ {10} \) to augment supplies from the State Water Project because of critically dry conditions and a federal court ruling that restricted pumping on the State Water Project.

The last large area of expenditures is for operations and maintenance. MWD’s operations and maintenance costs include, among other things, labor and benefits costs; costs incurred for chemicals, electricity, and sludge disposal during the water treatment process; operating equipment costs; and professional service payments to outside consultants for specialized skills. Budgeted operations and maintenance costs increased by $46.4 million (14 percent), from $327.5 million in fiscal year 2007–08 to $373.9 million in fiscal year 2011–12. The largest increase occurred between fiscal years 2010–11 and 2011–12, when budgeted operating and maintenance costs increased by $36.5 million (11 percent). This increase occurred for a variety of reasons. For instance, budgeted labor costs included a $6.6 million increase to cover projected merit increases and benefit cost increases, budgeted costs for retirement benefits increased by $10 million, budgeted costs for operating equipment increased by $4.9 million, and budgeted costs for water treatment chemicals increased by $1.6 million.

\(^ {10} \) A water transfer occurs when an entity with water rights sells or leases surplus water to another entity.
Even though certain areas of MWD’s budgeted costs are increasing, we observed that MWD took some actions to control its costs. One of these actions was to defer certain capital projects. For instance, budget documents for fiscal year 2009–10, which coincides with the largest percentage increase in MWD’s Tier 1 treated water rates since 2008, indicate that MWD deferred nearly 20 projects totaling $240 million in that fiscal year, including projects related to upgrading and improving water treatment facilities. MWD’s budget documents also indicate that it took other steps, such as deferring the replacement of operating equipment by optimizing the use of equipment that has experienced lower utilization. The budgeted amount for operating equipment decreased by $2.7 million (28 percent) from fiscal years 2007–08 to 2011–12. In addition, MWD’s budget documents indicate it has eliminated 148 positions, a reduction of 7 percent, from 2,069 positions in fiscal year 2007–08 to 1,921 in fiscal year 2011–12.

MWD has a high percentage of fixed costs that are independent of the amount of water it sells. Examples of these fixed costs include portions of its State Water Project expenses, as well as debt service costs related to bonds issued to help fund capital projects. When setting its rates for fiscal year 2011–12, MWD estimated that more than 80 percent—roughly $1.2 billion—of its anticipated expenditures were fixed costs, while water sales typically account for approximately 90 percent of its operating revenues.

In addition to increasing costs, MWD has faced declining water sales, which resulted in more of its costs being spread over a given unit of water sold. As stated earlier, MWD’s total water sales declined by 20 percent from fiscal years 2007–08 through 2011–12. The manager of MWD’s Water Resource Management Group stated that demands for deliveries from MWD are quite volatile from year to year and indicated that a 20-percent decline or increase over a few years is not uncommon. The manager stated that the single largest variable that changes demand for MWD water and its use, largely outdoor water use, from year to year is weather. The manager also stated that weather alone can swing retail demands by almost 10 percent in a given year and that recent weather has been remarkably cool in MWD’s service area, which has led to lower demands overall. MWD documents also indicate that the economic recession and its associated impacts such as job losses, income losses, and housing foreclosures affect MWD’s sales and that it anticipates demands for water will increase if economic conditions return to pre-recession levels.
Local Wholesalers Have Increased the Portions of Their Rates Not Tied to Imported Water, in Large Part Because of Efforts to Develop Alternate Water Sources

Rates charged by local wholesalers—specifically the West Basin District and Central Basin District—to their retail customers have increased since fiscal year 2007–08 for several reasons. As local wholesalers, the Central Basin and West Basin districts spend a significant portion of their budget to purchase imported water from MWD; however, they are also spending large amounts to develop alternative sources of water, such as systems to provide access to recycled or desalted water, and these activities currently add to the cost of the imported water that consumers use. Only customers of retailers that acquire their water from local wholesalers rather than directly from MWD feel the impact of these added costs.

Like other water suppliers we examined, local wholesalers set their rates in order to generate revenue sufficient to cover their projected expenses in the coming budget year. The volume-based rates that local wholesalers charge their retail customers include two basic components: an amount the wholesalers describe as passed through from MWD for the cost of imported water (MWD component), and amounts the wholesalers add to cover their own costs (wholesaler component). The Central Basin District’s wholesaler component includes two charges: an administration surcharge and an infrastructure surcharge. According to the Central Basin District’s management team, the infrastructure surcharge covers some of the costs of debt used to develop water recycling capacity, and the administration surcharge covers the district’s operational costs. The West Basin District’s wholesaler component includes a single charge: a reliability service charge. Budget documents for the West Basin District stated that the reliability service charge covers its operational costs, such as those associated with its water recycling operations. The wholesaler component makes up about 10 percent of the rates the Central Basin and West Basin districts charge retail customers for imported water.

As Figure 6 on the following page shows, the wholesaler components charged by the Central Basin and West Basin districts have more than doubled since July 2008. The Central Basin District’s wholesaler component increased by $46 (105 percent) per acre-foot, from $44 in fiscal year 2007–08 to $90 in fiscal year 2011–12. The West Basin District’s wholesaler component increased by $66 (161 percent) per acre-foot, from $41 in fiscal year 2007–08 to $107 in fiscal year 2011–12.

The wholesalers also have fixed costs, but we did not include these in our discussion of overall rates because they are based on customer-specific variables such as past usage and water capacity.
Figure 6
Local Wholesalers’ Components of Rates for Treated Water
July 2008 Through July 2012

Sources: Water rates and charges tables provided by the local wholesalers.
Notes: The rates shown represent the additional costs local wholesalers add to the cost of treated water imported from the Metropolitan Water District of Southern California. Specifically, the amounts shown for the West Basin Municipal Water District (West Basin District) pertain to its reliability service charge. Similarly, the amounts shown for the Central Basin Municipal Water District (Central Basin District) pertain to its infrastructure surcharge and its administrative surcharge. Finally, the amounts shown do not reflect any additional fixed charges, such as capacity charges and monthly service charges, which are dependent on the specific circumstances of each water retailer receiving water from the West Basin District or the Central Basin District.

Because the local wholesalers base their proposed rate increases on the expenses they expect to incur in an upcoming fiscal year, we examined how their budgeted expenses have increased since 2008 to better understand why their water rates increased. The largest category of budgeted expense for both local wholesalers is imported water from MWD. As Table 2 shows, the cost of MWD’s imported water and the readiness-to-serve (RTS) charge made up 73.2 percent of the Central Basin District’s budget for fiscal year 2012–13. According to MWD, the RTS charge reflects the cost of MWD providing standby services, such as emerging storage. Similarly, Table 3 on page 24 shows that the cost of MWD’s imported water made up 57.1 percent of the West Basin District’s budget for fiscal year 2012–13.

To identify areas of expense added by the local wholesalers, we looked specifically at the expenses that are not a direct cost of imported water. When we subtracted the cost of MWD’s imported water, four remaining categories made up more than 70 percent of the budget for the Central Basin District: debt service, water recycling operations, public/external operations, and district administration. Similarly, debt service and recycling operations made up more than 75 percent of the remaining budget for the West Basin District.
Table 2
Central Basin Municipal Water District’s Budgeted Expenditures
Fiscal Years 2008–09 Through 2012–13

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Imported water purchase readiness-to-serve (RTS)</td>
<td>$31,613,200</td>
<td>$41,372,211</td>
<td>$42,281,070</td>
<td>$47,549,800*</td>
<td>$50,857,600*</td>
<td>73.2%</td>
<td>61%</td>
</tr>
<tr>
<td>Debt service</td>
<td>3,854,499</td>
<td>3,945,427</td>
<td>3,912,023</td>
<td>4,798,735</td>
<td>4,752,390</td>
<td>6.8</td>
<td>23</td>
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<tr>
<td>Public/external affairs</td>
<td>2,578,754</td>
<td>2,172,070</td>
<td>2,001,079</td>
<td>3,117,692</td>
<td>3,172,524</td>
<td>4.6</td>
<td>23</td>
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<tr>
<td>Water recycling operations</td>
<td>2,493,231</td>
<td>2,495,945</td>
<td>2,502,768</td>
<td>3,173,998</td>
<td>2,708,153</td>
<td>3.9</td>
<td>9</td>
</tr>
<tr>
<td>District administration</td>
<td>1,750,667</td>
<td>2,431,202</td>
<td>3,303,059</td>
<td>2,726,408</td>
<td>2,538,329</td>
<td>3.7</td>
<td>45</td>
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<tr>
<td>Designated funds</td>
<td>1,376,902</td>
<td>1,251,709</td>
<td>1,539,061</td>
<td>2,276,718*</td>
<td>1,592,470*</td>
<td>2.3</td>
<td>16</td>
</tr>
<tr>
<td>Water Quality Protection Project (WQPP) operations</td>
<td>1,176,270</td>
<td>1,197,069</td>
<td>1,246,574</td>
<td>1,226,112</td>
<td>1,190,042</td>
<td>1.7</td>
<td>1</td>
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<tr>
<td>Capacity charge</td>
<td>1,027,556</td>
<td>917,000</td>
<td>943,200</td>
<td>833,230*</td>
<td>833,230*</td>
<td>1.2</td>
<td>(19)</td>
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<tr>
<td>Water resource planning</td>
<td>389,135</td>
<td>230,647</td>
<td>340,154</td>
<td>1,209,833</td>
<td>1,565,194</td>
<td>2.2</td>
<td>302</td>
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<tr>
<td>District Local Resources Program (LRP) rebate</td>
<td>199,356</td>
<td>265,600</td>
<td>265,600</td>
<td>265,600*</td>
<td>265,600*</td>
<td>0.4</td>
<td>33</td>
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<tr>
<td><strong>Totals</strong></td>
<td><strong>$46,459,570</strong></td>
<td><strong>$56,278,880</strong></td>
<td><strong>$58,334,588</strong></td>
<td><strong>$67,178,126</strong></td>
<td><strong>$69,475,532</strong></td>
<td><strong>100%</strong></td>
<td><strong>50%</strong></td>
</tr>
</tbody>
</table>

Sources: Central Basin Municipal Water District’s (Central Basin District) approved budgets for fiscal years 2008–09 through 2012–13.
Notes: The amounts shown in the table are based on the Central Basin District’s budgeted expenses for the fiscal years shown. We did not audit these amounts. The table focuses on budgeted expenses as opposed to actual expenses, since the Central Basin District establishes its water rates concurrently with its budgeted (or projected) costs. Some key terms shown in the table are defined below:

Imported water purchase/RTS: These are amounts the Central Basin District expects to pay the Metropolitan Water District of Southern California (MWD) for imported water as well as MWD’s RTS charge. According to MWD, the RTS charge reflects the cost of MWD providing standby service, such as emergency storage.

Designated funds: Planned revenues in excess of the Central Basin District’s budgeted expenditures are placed in certain funds that can be allocated by the Central Basin District’s board of directors at its discretion.

WQPP operations: The WQPP is intended to protect local groundwater from certain contaminants by extracting impaired water and treating it to meet drinking water standards.

Capacity charge: MWD charges the Central Basin District this fixed amount annually based on the Central Basin District’s peak water usage over a three-year period.

District LRP rebate: Under its LRP, the Central Basin District issues rebates to certain water retailers that have undertaken construction efforts to expand the Central Basin District’s recycled water system.

* The Central Basin District’s budget documents for fiscal years 2011–12 and 2012–13 did not provide data for certain cost elements. As a result, certain amounts are based on the assertions of the Central Basin District’s management.

Regarding debt service, both districts incurred a significant portion of their debt to fund the construction of facilities necessary to deliver recycled water to industrial, commercial, and irrigation sites, thereby reducing the districts’ reliance on imported water. The Central Basin District funded the Southeast Water Reliability Project, which delivers recycled water to the cities of Pico Rivera and Montebello. The district currently has three bond issues outstanding to fund its recycled water efforts.

For the West Basin District, recycling operations make up more than 40 percent of the district’s non-MWD budget. According to the West Basin’s operating budget, the costs of recycling operations include payments to the contractor operating the recycling
facilities. West Basin, like Central Basin, sells recycled water for industrial and irrigation uses. However, West Basin also sells recycled water for injection into the local groundwater basin to prevent seawater intrusion and replenish groundwater supplies.

### Table 3

<table>
<thead>
<tr>
<th>West Basin Municipal Water District's Budgeted Expenditures</th>
<th>Fiscal Years 2007–08 Through 2011–12 (Dollars in Thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Imported water</td>
<td>$80,242</td>
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<tr>
<td>Debt service</td>
<td>22,834</td>
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<tr>
<td>Recycling operations</td>
<td>20,439</td>
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<tr>
<td>Public information/conservation</td>
<td>6,789</td>
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<tr>
<td>Designated funds</td>
<td>4,425</td>
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<tr>
<td>Resource planning/water policy</td>
<td>1,224</td>
</tr>
<tr>
<td>Desalter operations</td>
<td>611</td>
</tr>
<tr>
<td>Totals</td>
<td>$136,564</td>
</tr>
</tbody>
</table>

Sources: West Basin Municipal Water District’s (West Basin District) operating budgets for fiscal years 2008–09 through 2012–13.

Notes: The amounts in the table are based on the West Basin District’s budgeted expenses for the fiscal years shown. We did not audit these amounts. The table focuses on budgeted expenses, as opposed to actual expenses, since the West Basin District establishes its water rates concurrently with its budgeted (or projected) costs. Some key terms shown in the table are defined below:

- **Imported water:** These amounts include the amounts the West Basin District budgeted for water purchases and the Metropolitan Water District of Southern California’s (MWD) capacity charge and readiness-to-serve (RTS) charge. According to MWD, the RTS charge reflects the cost of MWD providing standby service, such as emergency storage.
- **Designated funds:** Designated funds are the balance between total revenues and total expenses.
- **Desalter operations:** The desalter operations budget includes oversight, operation, and maintenance of the desalter, along with other costs of treating brackish water to meet drinking water standards.

### Different Cost Factors and a Desire to Promote Conservation Contributed to Retailers’ Rate Increases

The water rates charged by the three water retailers we reviewed increased from 2008 through 2012. As indicated in Figure 7, the monthly cost of 20 units of water purchased from LADWP rose from $60.64 in July 2008 to $84.05 in July 2012, an increase of $23.41 (39 percent). Over the same time period and for the same amount of water, Golden State Water’s monthly costs increased by $33.45 (50 percent), from $66.71 to $100.16. For water purchased from Downey, the monthly cost for 20 units of water increased by $15.09 (64 percent), from $23.48 to $38.57.
Because retailers set their rates based on the amount of budgeted expenses they expect to incur for the upcoming year, we examined each retailer’s budgeted expenses and changes to those budgeted amounts over time.

Water bills increased for LADWP’s consumers for a variety of reasons, such as increasing capital-related costs and the higher costs of purchasing water from MWD. According to its staff, LADWP’s budget for interest and depreciation expense increased by $64.1 million and $38.2 million, respectively, from fiscal years 2008–09 through 2012–13. This represented an increase of 69 percent in interest expense and 44 percent in depreciation expense. According to its audited financial statements, LADWP issued roughly $500 million in revenue bonds in fiscal year 2009–10. The net proceeds from the issuance of these bonds were deposited into the Construction Fund to be used for capital improvements. According to LADWP’s water executive managing engineer, the increase in interest expense was a result of the issuance of these bonds, and the increase in depreciation expense was a result of the funds from these bonds being used for new capital improvement projects.

**Figure 7**

Monthly Bill for 20 Units of Water Purchased From Three Water Retailers 2008 Through 2012

Sources: Historical and proposed water rate data provided by each retailer.

Notes: The amounts shown in the figure represent the total monthly water bill for a hypothetical residential customer with a family of four. The figure assumes this family would consume 20 units of water; one unit equals 100 cubic feet (HCF), or approximately 748 gallons. The dollar amounts shown include both the retailer’s fixed and variable charges.

Our analysis focused on 20 units of water as a benchmark for residential use based on data provided in the California Department of Water Resources’ 20x2020 Water Conservation Plan (conservation plan), published February 2010. The conservation plan provides baseline consumption data indicating that residential customers in the Los Angeles area used 126 gallons per capita per day in 2005. After multiplying this amount by four people and 365 days a year, and converting the result into monthly units of water, we arrived at 20 units—or 20 HCF—as a monthly benchmark.

* Almost $8 of the $100.16 monthly water bill is because the California Public Utilities Commission authorized the Golden State Water Company to recover revenue shortfalls from prior years in its current rate.
LADWP’s budget documents show that the cost of purchased water increased by $47.7 million (26 percent), from $185.3 million in fiscal year 2008–09 to $233 million in fiscal year 2012–13. According to LADWP’s water executive managing engineer, this increase was because of increases in MWD’s water rates. In addition, LADWP modified its tiered rate structure to encourage conservation. In March 2009 LADWP’s board of commissioners declared that the water supply available was insufficient to meet the city’s normal water demand. Its solution was to reduce the amount of water a consumer can purchase at the lower Tier 1 rate from 18 units to 15 as of June 1, 2009. Concurrently, it increased the Tier 2 rate by 55 percent. Before the modification, a consumer paid $60.64 for 20 units of water. After the modification, the consumer pays $78.73, a 30 percent increase.

Water costs increased for customers of Golden State Water in part because it implemented a new rate structure whereby those customers who do not conserve water will incur higher rates. According to financial reports it filed with the U.S. Securities and Exchange Commission, Golden State Water implemented a tiered structure in November 2008 to promote conservation among its consumers. After the new structure took effect, consumers using more than 20 units of water in a billing cycle paid about 19 percent more. Before the modification, a consumer would pay $66.71 for 20 units of water; after the modification, the consumer would pay $79.32.

Golden State Water’s water rate also increased to allow it to earn a certain rate of return, or profit, based on its growing assets. According to the CPUC, which regulates Golden State Water, the value of property and assets on which an investor-owned water utility is permitted to earn a specified rate of return is called a rate base. Golden State Water’s rate base increased each year since 2008. Golden State Water is required to get approval from the CPUC for any change in its rate of return, rate base, and any acquisition of new assets. Acquisition of new assets by any investor-owned utility must be approved by the CPUC before they are implemented, and once in service the assets are included in the rate base. According to its vice president of regulatory affairs, Golden State Water’s rate base increased as a result of its investing in new assets to help maintain and replace aging infrastructure.

Two primary factors contributed to Downey’s water rate increases: increases in the cost of pumping groundwater and the cost of eliminating a deficit. According to its budget documents, Downey’s budget for water supply costs increased by roughly 30 percent from fiscal years 2008–09 to 2012–13. During that same period, water supply costs accounted for nearly 52 percent of Downey’s overall water budget. According to Downey’s finance director, the increase in water supply expenses was most significantly the result of
increases in the assessment fee being charged by the replenishment district for pumping groundwater. The replenishment district’s assessment increased from $153 per acre-foot in fiscal year 2008–09 to $244 per acre-foot in fiscal year 2012–13, or nearly 60 percent. Regarding the deficit, Downey’s budget documents show that the city’s Water Fund operated at a loss from fiscal years 2008–09 to 2010–11. In each year, Downey’s budgeted Water Fund expenses exceeded revenues—by $290,000 in 2008, $1.3 million in 2009, and $1.9 million in 2010. Downey’s finance manager explained that during those years, the city tapped into its reserves to cover its losses. To help resolve the deficit situation, Downey officials hired an outside consultant to develop a water supply master plan that included a rate structure that would help ensure that Downey had a self-supported Water Fund. Downey’s new rate structure included four tiers of rates and annual rate increases of varying percentages from July 2011 through July 2015.

**Portions of Downey’s Water Fees May Not Be Allowable Under the California Constitution**

Downey’s water rates may generate funds that exceed the amount required to provide its water services, which would violate the California Constitution. Under Article XIII D of the California Constitution, which was added by Proposition 218 in 1996, a property-related fee or charge shall not be extended, imposed, or increased by an agency unless it meets certain requirements. These requirements include provisions that revenues derived from the fee or charge shall not exceed the funds required to provide the property-related service and that these revenues shall not be used for any purposes other than that for which the fee or charge was imposed. In addition, fees or charges based on potential or future use of a service are not permitted. Article XIII D also specifies that the local agency imposing a fee bears the burden of proving that the fee complies with the article. In 2006 the California Supreme Court determined that a local public water agency’s charges for ongoing water delivery are property-related fees under Article XIII D. In other words, water fees paid by customers of these agencies are subject to the requirements of Article XIII D.

Downey transferred revenues generated from water fees for uses that it was unable to sufficiently substantiate were related to water service. During fiscal years 2007–08 through 2010–11, Downey transferred
to other governmental funds almost $1 million from its Water Fund, which is used to account for the provision of water services to residential, commercial, and industrial customers. Downey’s financial statements indicate that these transfers were made to provide funding for capital expenditures. When we asked Downey for specific details on the amounts transferred to its Sewer and Storm Drain Fund, which is used to account for charges collected for the upkeep of sanitary sewers and federally required drainage upkeep programs, Downey’s finance manager explained that the Water Fund paid for the costs incurred by its stormwater engineering division, which helps to ensure that runoff water entering the storm drain system is clean so that rivers and oceans are not polluted. Our legal counsel advised us that court decisions interpreting Article XIII D have not prohibited local governments from charging its customers water fees that would recoup the costs of the government’s water department on other government departments, as long as these fees reasonably represent such costs. However, Downey staff was unable to provide sufficiently detailed evidence to convince us that the transfers from its Water Fund to the Sewer and Storm Drain Fund were for water-related purposes. Because Downey was unable to provide support for which costs the transferred amounts were supposed to recoup, we question the legality of these transfers.

In addition, in fiscal year 2010–11 Downey transferred $3.3 million from its Water Fund to its Transit Fund, which is used to account for Downey’s city-operated bus service for senior citizens and disabled individuals and the fixed-route DowneyLINK bus system. Downey staff provided us with documents showing that the transfer was made to acquire property, in part to accommodate a possible future water treatment plant, and Downey’s utilities manager stated that the transfer was made to acquire property necessary to implement water treatment facilities in the future. Downey initially could not provide us with sufficient evidence supporting its recent efforts to construct such a treatment facility. For instance, although Downey’s capital improvement plan mentioned the treatment facility, the facility was not listed as a priority. Rather, Downey included it as the fourth of four priorities on its list of potential projects that could be added should funding allow. We questioned whether the funds used to acquire the property for the treatment facility could be considered fees based on potential or future use of a service, which are prohibited by Article XIII D. However, our legal counsel did not identify any case law that directly addressed this issue. Moreover, other case law suggests that water fees could be used to pay for long-term capital expenditures. Regardless, in December 2012, the Downey city council enacted a resolution authorizing the city manager to apply for and submit all required documents to obtain funding for the treatment facility. This resolution mitigated our concern that the fees used to purchase the land were based on a potential or future use of water services.
Mechanisms Exist for the Public to Provide Input Into Rate Increases, but They Could Be More Effective

Given the disparity in water rates charged by retailers and the overall trend of increasing water rates in southeastern Los Angeles County, we examined the processes water suppliers use to set their rates and the protections and safeguards in place to help ensure that consumers are protected from unreasonable rate increases. With water, because a consumer’s physical location determines the one retailer that will provide water, the consumer cannot choose among retailers to obtain the lowest rate. Given this lack of direct competition, there is increased risk that water suppliers might charge unjustifiably high rates unless mechanisms exist to effectively challenge proposed rate increases.

MWD has several mechanisms that help ensure that its rates are set appropriately. MWD’s 37-member governing board consists of representatives from the 26-member agencies to which MWD sells imported water. Although MWD is a government entity and is governed by a board of directors, its directors are not elected to their positions by voters. Instead, the 26-member agencies each appoint at least one representative to MWD’s board, with additional members representing agencies that have at least 5 percent of the district’s property value. Therefore, when proposals to increase water rates are presented to the board, the representatives are, in effect, voting to increase the rates the agencies they represent will pay. Also, MWD held public board meetings for the rate increase we selected to review. The public was allowed to attend and participate in these meetings, including voicing objections to the proposed rate increases. Finally, ratepayers can resort to the courts to resolve concerns about rates or the rate-setting process. For example, in June 2010 and June 2012 the San Diego County Water Authority filed lawsuits against MWD contending that some of MWD’s rates applied unfairly to the authority.

For local wholesalers, two mechanisms help ensure appropriate water rates: transparency and the election process. The two local wholesalers considered the proposed rates that we reviewed at public hearings or meetings held by their governing boards. The public was allowed to attend and participate in these hearings or meetings, and could voice objections to proposed rate increases. Further, publicly elected governing board members represent consumers in the two local wholesalers’ service areas. Consumers can contact their representative on these boards to voice concerns about water rate increases. Consumers are also free to use the election process to replace their representatives on the wholesaler’s board if they are not satisfied with the board’s actions.
The mechanisms that exist to protect ratepayers from unjustified rate increases by retail water suppliers depend on whether the retailer is government operated or investor owned. For government-operated retailers, these mechanisms include transparency and consumer advocacy. Government-operated retailers often hold public meetings at which they discuss rate proposals and accept public comment. In addition, they adopt their rates at public meetings, such as city council meetings. Investor-owned retailers support their proposed rate increases with documentary evidence and testimony when they file a general rate case with the CPUC. Members of the public and consumer groups can participate in general rate cases either informally through written or verbal public comments or formally as an intervenor in the case. Moreover, the CPUC’s Division of Ratepayer Advocates represents consumer interests in proceedings with the CPUC.

Proposition 218, passed by voters in 1996, amended the California Constitution to enact procedures to be followed when a local government adopts, extends, or increases taxes, property-related assessments, or property-related fees and charges for, among other things, water service. It requires local government-operated retail water suppliers to provide property owners with written notice of any proposed rate increase at least 45 days in advance of a public hearing, and to explain the purpose for any increase. Proposition 218 prohibits local government-operated retail water suppliers from increasing rates if a majority of property owners present written protests.

In general, our review of selected rate increases found that the local government-operated retail water agencies we reviewed adhered to the notice, hearing, and protest requirements of Proposition 218 when increasing fees and charges for water service. For example, in August 2007, LADWP proposed water rate increases needed in part to maintain and upgrade its water system infrastructure. LADWP informed its customers of the proposed increase 45 days in advance of the public hearing, identified the date and location of the hearing, and provided an address to which ratepayers could submit written comments. LADWP also held several rate proposal workshops and public meetings with neighborhood associations and the public to discuss the proposed increase. The Los Angeles city council held a public hearing in October 2007 at which it heard protests against the rate increase. We asked LADWP how many written protests it had received, and LADWP pointed us to documents indicating that less than a majority of the more than 600,000 water customers in LADWP’s service area had submitted written protests. The city council also listened to eight verbal protests against the proposed increase at the hearing. The Los Angeles city council subsequently approved the increase.
Similarly, in April 2011, Downey proposed water rate increases to achieve several purposes, including eliminating a projected $2 million deficit in its Water Fund and funding capital improvement projects. Downey informed its customers of the proposed increase at least 45 days in advance of the public hearing, identified the date and location of the hearing, and provided an address to which ratepayers could submit written protests. The Downey city council held the public hearing in June 2011, at which the city disclosed that it had received 22 written protests against the rate increase, which, the city attorney advised, did not meet the threshold of 50 percent plus one to defeat the proposed rates. The city council also listened to three verbal protests against the proposed increase at the hearing. The Downey city council subsequently approved the increase by a vote of 5 to 0.

LADWP has an additional mechanism—a consumer advocate—to help provide independent analysis of department actions as they relate to water and electricity rates. In 2011 Los Angeles voters passed a charter amendment to create the Office of Public Accountability (accountability office) to provide greater transparency of LADWP’s operations and finances and to analyze proposed increases in water and power rates on a timely and continuous basis. The charter amendment also required that the accountability office include a ratepayer advocate. In February 2012 Los Angeles appointed its first ratepayer advocate within the accountability office. The ratepayer advocate’s responsibilities include reviewing the rates, the city’s budget and needs, and other relevant issues, including complaints brought by consumers. This individual also is responsible for reviewing proposed rate changes before they are presented to LADWP’s board. The accountability office is funded by the city at not less than 0.025 percent of the LADWP’s annual revenues. According to the city of Los Angeles’ voter information packet, the accountability office is anticipated to cost at least $1 million per year. While the ratepayer advocate has issued reports on power rate increases, as of early November 2012, he has not yet issued a report on a proposed water rate increase.

Although the mechanisms discussed here are in place to help ensure that water rates and rate increases are justifiable, they may contain flaws that reduce their effectiveness. For instance, although the constitutional provisions put in place by Proposition 218 promote transparency for increased water rates paid by the public and the purposes to be achieved by those increases, the likelihood that a majority of individual property owners in a given service area would submit a sufficient number of written protests seems remote, based on the examples we reviewed. LADWP has more than 600,000 water customers and would need to receive hundreds of thousands of written protests from its customers’ property owners to avoid implementing a proposed rate increase. Given the
limited number of protests received in 2012, it seems unlikely that LADWP would ever receive sufficient protests to force it to reject a rate increase.

Unlike government-operated retailers, investor-owned retailers follow a different rate-setting process, one that is overseen by the CPUC. State law prohibits public utilities such as private (investor-owned) water retailers from imposing a new rate until the CPUC finds that the new rate is justified. The CPUC approves rates for large investor-owned water retailers such as Golden State Water through what it calls a “general rate case” process. This process is similar to a court hearing in that it occurs in front of an administrative law judge. One party—the investor-owned retailer—provides evidence such as documentation and testimony to support the need for a rate increase in a rate case application, while another party—the CPUC’s Division of Ratepayer Advocates—analyzes the application and makes a recommendation about the proposed rate increase that represents consumer interests.

The CPUC process sets water rates for a three-year cycle. According to the supervisor of the CPUC’s Division of Water and Audits Program, the first year of the cycle is called the test year. The retailer presents detailed evidence for that year. The other two years are called escalation years. The CPUC allows for rate adjustments in the escalation years by applying something similar to a consumer price index adjustment to the test year. Shortly after the water supplier files a general rate case, the CPUC assigns it to one of its five governor-appointed commissioners and to an administrative law judge. The CPUC’s goal is to complete general rate case proceedings within 18 months.

If the parties in the general rate case filing reach a settlement, they can file a motion to adopt the settlement with the commissioners. The CPUC will then litigate any remaining issues the parties have not settled before the assigned administrative law judge. At the conclusion of the hearing, the administrative law judge issues a proposed decision. The proposed decision includes the judge’s recommended ruling on the litigated issues, as well as the judge’s ruling regarding any proposed settlement the parties have filed.

According to a program and project supervisor in the CPUC’s Division of Water and Audits Program, once the judge issues the proposed decision, a comment period allows the parties to comment on it. After the comment period, the proposed decision is placed on the CPUC’s public agenda at its open meeting for a vote by the five CPUC commissioners. As a final step in the process, any commissioner can issue his or her own alternate proposed
decision for consideration. The commissioners consider the proposed decision, as modified in response to comments, at their open meetings.

Although interested parties such as cities or individual consumers may participate in general rate cases filed with the CPUC, they do not always take advantage of the opportunity. In its general rate case before the CPUC to increase water rates beginning in 2010, Golden State Water applied to increase its rates to generate an additional $20 million in revenue for 2010. During the general rate case, aside from the CPUC’s Division of Ratepayer Advocates, no representatives from Golden State Water’s Region 2 (which covers much of southeastern Los Angeles County) were parties to the proceeding.

**Water Agencies’ Spending on Legal Services Has Little Effect on the Cost of Water**

When faced with increasing water rates, some customers may question whether the water suppliers may be making poor spending decisions—for instance, on litigation involving other water suppliers, administrative overhead, or other factors—that are to blame. Our audit revealed that legal and administrative expenses constituted relatively modest proportions of the overall costs for the seven water suppliers we examined. Finally, we found that reserve levels for the seven suppliers were not excessive and in some instances suppliers used those reserves to decrease costs to customers.

As reflected in the text box, the delivery of water in Los Angeles takes place in a litigious environment. In all, the water suppliers we audited participated in several lawsuits involving other water suppliers since 2008. When we examined the amounts that the suppliers spent on legal services, we found that the costs contributed very little to each water supplier’s annual costs and ultimately to the cost of water. Table 4 on the following page shows that from fiscal years 2007–08 through 2011–12, legal costs generally accounted for 1 percent to 2 percent of water suppliers’ total operating costs, though individual annual amounts varied from less than 1 percent to about 8 percent.

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**Water Delivery in Los Angeles Takes Place in a Litigious Environment**

The entities we audited provided us with information regarding litigation taking place from fiscal years 2007–08 through 2011–12. These seven entities identified more than 30 different lawsuits. Some high-profile litigation currently pending includes:

**San Diego County Water Authority vs. Metropolitan Water District of Southern California (filed June 2010)**

San Diego alleges that the Metropolitan Water District of Southern California has imposed unlawful water rates that overstate the costs of transporting water to San Diego.

**City of Cerritos, et al. vs. Water Replenishment District (filed August 2010)**

Various cities challenged the Water Replenishment District of Southern California’s replenishment assessment, stating that it violated Article XIII D of the State Constitution.

Sources: Officials from the seven entities included in our audit as noted in the Scope and Methodology section of our report.
### Table 4
Legal Costs as a Percentage of Total Operating Expenses
Fiscal Years 2007–08 Through 2011–12
(Dollars in Thousands)

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<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Metropolitan Water District of Southern California</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legal costs</td>
<td>$8,978</td>
<td>$9,889</td>
<td>$7,168</td>
<td>$8,223</td>
<td>$5,164</td>
</tr>
<tr>
<td>Percentage of total operating expenses</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>&lt;1%</td>
</tr>
<tr>
<td>Central Basin Municipal Water District</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legal costs</td>
<td>$993</td>
<td>$1,235</td>
<td>$1,425</td>
<td>$1,672</td>
<td>$5,206</td>
</tr>
<tr>
<td>Percentage of total operating expenses</td>
<td>2%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
<td>*</td>
</tr>
<tr>
<td>West Basin Municipal Water District</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legal costs</td>
<td>$255</td>
<td>$410</td>
<td>$292</td>
<td>$299</td>
<td>$259</td>
</tr>
<tr>
<td>Percentage of total operating expenses</td>
<td>&lt;1%</td>
<td>&lt;1%</td>
<td>&lt;1%</td>
<td>&lt;1%</td>
<td>&lt;1%</td>
</tr>
<tr>
<td>City of Downey Department of Public Works</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legal costs</td>
<td>$6</td>
<td>$87</td>
<td>$801</td>
<td>$818</td>
<td>$494</td>
</tr>
<tr>
<td>Percentage of total operating expenses</td>
<td>&lt;1%</td>
<td>1%</td>
<td>8%</td>
<td>8%</td>
<td>*</td>
</tr>
<tr>
<td>City of Los Angeles Department of Water and Power (LADWP)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legal costs</td>
<td>$593</td>
<td>$593</td>
<td>$593</td>
<td>$593</td>
<td>$593</td>
</tr>
<tr>
<td>Percentage of total operating expenses</td>
<td>&lt;1%</td>
<td>&lt;1%</td>
<td>&lt;1%</td>
<td>&lt;1%</td>
<td>&lt;1%</td>
</tr>
<tr>
<td>Water Replenishment District of Southern California (replenishment district)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legal costs</td>
<td>$583</td>
<td>$583</td>
<td>$583</td>
<td>$583</td>
<td>$583</td>
</tr>
<tr>
<td>Percentage of total operating expenses</td>
<td>2%</td>
<td>2%</td>
<td>1%</td>
<td>1%</td>
<td>*</td>
</tr>
</tbody>
</table>

*Not available. These entities did not provide CAFRs for fiscal year 2011–12 in time for us to include this information in our report.

Sources: Assertions from the seven suppliers and applicable Comprehensive Annual Financial reports (CAFRs) or other financial reports for the years noted.

Notes: The amounts shown in the table reflect each entity’s assertion about the amount of legal-related expenditures incurred for the years shown. We did not audit these amounts.

The amounts shown generally represent attorney fees paid to outside legal counsel to assist in litigation or other legal matters but may also include other expenses such as paid claims resulting from disputes. LADWP and the replenishment district provided their cost information over a five-year period, which we present as an average across each year shown in the table. Finally, Golden State Water’s fiscal year coincides with the calendar year.

The lawsuits we examined covered a wide variety of issues. The San Diego County Water Authority sued MWD in June 2010 and June 2012 over the rates MWD charged. The San Diego County Water Authority believes that some of MWD’s rates unfairly result in higher costs for the authority. These lawsuits were still ongoing in early December 2012. In another case,
three cities filed suit against the replenishment district in August 2010, stating that the process the district used to approve replenishment assessment amounts did not comply with the constitutional provisions enacted by Proposition 218. This lawsuit was still ongoing in early December 2012. Finally, the Central Basin District filed suit against the replenishment district in September 2011 for the rights to three Web sites that the Central Basin District claimed it should own. The Central Basin District eventually dropped this lawsuit in February 2012 after it spent almost $143,500 pursuing the case and the replenishment district spent almost $190,100 defending itself.

We also examined the amount of administrative expenses water suppliers incurred and found that spending in these areas was generally a modest portion of an entity’s operating costs. Table 5 on the following page shows that from fiscal years 2007–08 through 2011–12, administrative expenses accounted for between 2 percent and 38 percent of suppliers’ operating costs. Although Downey’s administrative costs constituted between 34 percent and 38 percent of the city’s total operating expenses from its Water Fund, Downey’s administrative costs of roughly $3.7 million per year was consistent with amounts spent by the Central Basin District and the West Basin District. Further, the percentages for these two districts—as shown in Table 5—are relatively lower when compared to Downey because both local wholesalers face substantially higher total operating costs resulting from the purchase of imported water. As a result, despite the higher percentage of general and administrative costs, Downey’s spending seems consistent with many of the suppliers we included in Table 5.

In addition to litigation and administrative expenses, we also examined how funds retained by water suppliers in the form of unrestricted reserves (reserves) changed from fiscal years 2007–08 through 2011–12. As Table 6 on page 37 demonstrates, the overall trend is that water suppliers’ reserves—when taken as a percentage of their operating expenses—have generally been declining. For example, Downey has seen its reserves for its Water Fund decrease from $9.6 million in fiscal year 2007–08, which represented 96 percent of its annual operating expenses, to nearly $600,000 in fiscal year 2010–11, representing 6 percent of its annual operating expenses. Other water suppliers, as shown in the table, have also seen more modest decreases in their reserve amounts. The one exception to this trend is LADWP, whose reserves have been steadily increasing.

Unrestricted reserves are funds that water suppliers can spend for any purpose they deem necessary and result from revenues that exceed their associated costs and capital contributions. Sometimes water suppliers target certain reserve amounts when preparing their annual budgets to ensure they have enough money available to cover unexpected expenditures, future capital outlay projects, or to help maintain strong credit ratings.
### Table 5
Administrative Costs as a Percentage of Total Operating Expenses
Fiscal Years 2007–08 Through 2011–12

(Dollars in Millions)

<table>
<thead>
<tr>
<th>SUPPLIER</th>
<th>FISCAL YEAR</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Metropolitan Water District of Southern California</td>
<td>Administrative costs</td>
<td>$89.7</td>
<td>$91.7</td>
<td>$78.0</td>
<td>$89.5</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>9%</td>
<td>9%</td>
<td>7%</td>
<td>9%</td>
</tr>
<tr>
<td>Central Basin Municipal Water District</td>
<td>Administrative costs</td>
<td>$3.7</td>
<td>$1.8</td>
<td>$3.5</td>
<td>$3.8</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>9%</td>
<td>5%</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>West Basin Municipal Water District</td>
<td>Administrative costs</td>
<td>$3.6</td>
<td>$2.8</td>
<td>$3.1</td>
<td>$2.9</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>3%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>City of Downey Department of Public Works</td>
<td>Administrative costs</td>
<td>$3.6</td>
<td>$3.3</td>
<td>$3.8</td>
<td>$3.7</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>36%</td>
<td>34%</td>
<td>36%</td>
<td>38%</td>
</tr>
<tr>
<td>City of Los Angeles Department of Water and Power</td>
<td>Administrative costs</td>
<td>$90.7</td>
<td>$89.8</td>
<td>$107.0</td>
<td>$94.6</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>15%</td>
<td>14%</td>
<td>16%</td>
<td>15%</td>
</tr>
<tr>
<td>Water Replenishment District of Southern California</td>
<td>Administrative costs</td>
<td>$5.3</td>
<td>$5.5</td>
<td>$5.6</td>
<td>$7.4</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>20%</td>
<td>18%</td>
<td>11%</td>
<td>13%</td>
</tr>
</tbody>
</table>

**Sources:** Comprehensive Annual Financial reports (CAFRs) or other entity-provided financial reports for the years noted.

**Notes:** The amounts shown in the table generally reflect each entity’s general and administrative expenses as a proportion of total operating expenses. We did not audit these amounts. Also, the data for Golden State Water pertains only to its Region 2 service area that includes Southern Los Angeles County. The amounts shown for Golden State Water are based on its statement of earnings reports. However, according to its vice president of regulatory affairs, the format of this report overstates the true administrative costs for Golden State Water’s Region 2 because the report includes the total allocated costs of Golden State Water’s other offices, such as its general office and regional headquarters. Golden State Water’s vice president estimates that the overstatement amounts to roughly $1.5 million per year.

* Not available. These entities did not provide CAFRs for fiscal year 2011–12 in time for us to include this information in our report.

Some water agencies have used their reserves to avoid increasing their water fees for consumers. According to budget documents provided by Downey for its Water Fund, its water operations had been operating at a loss during fiscal years 2008–09 through 2010–11. Although Downey did not change its water rates, budget documents indicate that its Water Fund operated at a deficit of $3.5 million over this three-year period. It was not until Downey increased its rates for fiscal year 2011–12.
that the annual deficit was corrected. Similarly, documents from the replenishment district indicated that the agency budgeted to use $8.3 million in reserves in fiscal year 2010–11 and $10 million in fiscal year 2011–12 to subsidize the replenishment assessment the agency collects from those who pump groundwater.

### Table 6

Reserves as a Percentage of Total Operating Expenses
Fiscal Years 2007–08 Through 2011–12

(Dollars in Millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Metropolitan Water District of Southern California</td>
<td>Reserves</td>
<td>$529.2</td>
<td>$503.2</td>
<td>$417.1</td>
<td>$466.7</td>
<td>$605.8</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>54%</td>
<td>47%</td>
<td>39%</td>
<td>45%</td>
<td>55%</td>
</tr>
<tr>
<td>Central Basin Municipal Water District</td>
<td>Reserves</td>
<td>$26.0</td>
<td>$23.3</td>
<td>$23.7</td>
<td>$28.8</td>
<td>*</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>63%</td>
<td>59%</td>
<td>46%</td>
<td>55%</td>
<td>*</td>
</tr>
<tr>
<td>West Basin Municipal Water District</td>
<td>Reserves</td>
<td>$79.5</td>
<td>$66.9</td>
<td>$55.5</td>
<td>$58.1</td>
<td>$62.6</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>69%</td>
<td>56%</td>
<td>40%</td>
<td>40%</td>
<td>42%</td>
</tr>
<tr>
<td>City of Downey Department of Public Works</td>
<td>Reserves</td>
<td>$9.6</td>
<td>$7.7</td>
<td>$5.1</td>
<td>$0.6</td>
<td>*</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>96%</td>
<td>79%</td>
<td>49%</td>
<td>6%</td>
<td>*</td>
</tr>
<tr>
<td>City of Los Angeles Department of Water and Power</td>
<td>Reserves</td>
<td>$39.8</td>
<td>$66.1</td>
<td>$160.8</td>
<td>$140.9</td>
<td>$250.0</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>7%</td>
<td>10%</td>
<td>24%</td>
<td>22%</td>
<td>39%</td>
</tr>
<tr>
<td>Water Replenishment District of Southern California</td>
<td>Reserves</td>
<td>$20.8</td>
<td>$34.7</td>
<td>$32.8</td>
<td>$19.0</td>
<td>*</td>
</tr>
<tr>
<td></td>
<td>Percentage of total operating expenses</td>
<td>77%</td>
<td>113%</td>
<td>67%</td>
<td>34%</td>
<td>*</td>
</tr>
</tbody>
</table>

Sources: Comprehensive Annual Financial reports (CAFRs) or other entity-provided financial reports for the fiscal years noted.

Notes: The amounts shown in the table reflect each entity’s unrestricted reserves, which can be spent however the entity deems is advisable and consistent with law. We did not audit these amounts. We have not included the Golden State Water Company (Golden State Water) in our table since its financial reports do not indicate it maintains reserves. Instead, Golden State Water is a privately operated entity whose capital structure consists of shareholder equity, long-term debt, and other credits.

* Not available. These entities did not provide CAFRs for fiscal year 2011–12 in time for us to include this information in our report.

LADWP reserve amounts increased by $210 million, or 528 percent, from fiscal years 2007–08 through 2011–12. LADWP’s manager of financial reporting stated that a large portion of this increase was due to loans from the State—$43.5 million from Water Resources to fund water-quality capital improvements and $55 million from the Department of Public Health to assist in financing construction of a project that will enable LADWP to meet safe drinking water standards—and that these funds can only be used for projects approved by the State.
Recommendations

To ensure that it can meet the burden of proof that its water fees comply with Article XIII D of the California Constitution, Downey should be able to provide, upon request, documentation that all transfers out of the Water Fund are for water-related purposes. Such documentation should be sufficiently detailed and understandable to the layperson.

If it believes that the mechanisms available to consumers in southeastern Los Angeles County to protect against unreasonable rates or rate increases are not sufficient, the Legislature should consider enacting additional consumer protection mechanisms. Mechanisms to consider include ratepayer advocacy positions similar to those used by the CPUC and LADWP.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the scope section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,

Elaine M. Howle, CPA
State Auditor

Date: January 29, 2013

Staff: Grant Parks, Audit Principal
       Dale A. Carlson, MPA, CGFM
       Amanda Garvin-Adicoff
       Jamahl A. Hill
       Joshua Hooper, CIA
       Joe Meyer, CPA, CIA

Legal Counsel: Scott A. Baxter, JD

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.
City of Downey
11111 Brookshire Avenue
Post Office Box 7016
Downey, California 90241-7016
December 20, 2012

Ms. Elaine M. Howle*
California State Auditor
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Re: Audit 2012-104 - Southeast Los Angeles County - Water Cost and Delivery-Draft Report

Dear Ms. Howle:

On December 14, 2012, the City received two (2) draft copies of the Southeast Los Angeles County - Water Cost and Delivery Audit Report ("draft report"). The City of Downey provides its comments and clarifications to the draft report and kindly requests that the City’s responses be considered in finalizing the draft report. Of course, the City’s staff is available to discuss these comments and provide additional documentation as your office deems necessary.

1. Draft Report Comment - Pages 4 and 5

“When examining water rates, we observed that portions of Downey’s rates may not be allowable under the California Constitution. Because Downey could not substantiate that almost $1 million in revenues that it transferred from its Water Fund to other funds were actually for specific water-related purposes, we question whether these transfers comply with the provisions of Article XIII D of the California Constitution, added by Proposition 218 in 1996. Under these provisions, revenues derived from a fee or charge cannot exceed the funds required to provide the service, revenues cannot be used for purposes other than those for which the fee or charge was imposed, and the local agency imposing the fee bears the burden of proving the fee complies with the article. We found that during fiscal year 2008-2009 through fiscal year 2010-11, Downey transferred almost $1 million from its Water Fund to other funds. Although Downey staff told us that the transfers to the Sewer and Storm Drain Fund paid for costs incurred by the stormwater engineering division, they were unable to provide sufficient documentation supporting what costs the transferred amount represented. Our legal counsel advised us that court decisions interpreting Article XIII D have not prohibited local governments from charging its customer water fees that would recoup the costs of the government’s water department on other departments, as long as these fees reasonably represent such costs. We therefore questioned the legality of these transfers.”

City Response:

Your office states in the draft report that the City was unable to substantiate with sufficient documentation that the “almost $1 million" in revenues that the City transferred from its Water Fund to other funds was for water-related activities. This statement is in fact, inaccurate.

* California State Auditor’s comments begin on page 47.
Over the course of the 6-month audit process, the City provided the following documents directly relevant to the revenues (which is closer to approximately $600,000 and not $1 million) that the City transferred from its Water Fund to other funds for water-related purposes:

1. Sewer and Storm Water Fund Capital and Engineering budget documents for Fiscal Years 07/08 and end-of-year expenditure reports;

2. Comprehensive Annual Financial Reports (CAFR) detailing the nature of the transfers.

These documents show that the transfer of the $600,000 of revenues from the Water Fund to other funds were for water-related purposes.

Second, the City submitted to your office annual budget documents for Fiscal Years 07/08 and 11/12, where the City Council reviewed and approved the allocation of Water Fund fees to the Sewer and Storm Drain Fund for water-related activities, specifically illustrating that:

1. The Water Fund received direct benefits from Storm Water Engineering efforts in the form of capturing and storage of runoff through development requirements and City projects to raise water levels for the City's groundwater wells, as well as for runoff compliance costs caused by the City's water system since all dry weather flows emanate from the City's source water; and

2. The Water Fund received direct benefits from the Sewer and Storm capital improvements by preventing contamination of the City's groundwater from leaking sewer pipes/facilities.

Lastly, this paragraph makes a blanket statement questioning generally City Water Fund transfers, when in fact, your office did not question all Water Fund transfers, but only certain transactions occurring in Fiscal Years 2009-2011 as we discussed on our last telephonic conference call on December 19, 2012.

Based on the aforementioned documentation coupled with the numerous conference calls with your office to explain the nexus between the transfer of Water Fund revenues to other funds, the City has more than met its burden of proof that the amounts of the water revenue transfers to other funds were adequately supported and justified under California Constitution Article XIII D. If your office determines to leave the above-referenced paragraph in the audit report, we request that the language acknowledge the fact that the City had provided a substantial number of documents (as listed above) to justify the Water Fund transfers and specify that only certain Water Fund transfers were questioned by your office.

2. Draft Report Comment - Page 6, 2nd Paragraph

“Recommendations

To ensure that it can meet the burden of proof that its water fees comply with Article XIII D of the California Constitution, Downey should be able to provide, upon request, documentation that all transfers out of the Water Fund are for water-related purposes. Such documentation should be detailed and understandable to the layperson.”

1 After the draft report was received by the City, your office notified city staff on December 19, 2012 (the day before this response was due to your office) that the original language under this heading would be changed. Accordingly, the City's comments contained herein respond to this modified language and not to the language appearing in the draft report.
City Response:

As discussed in more detail in Paragraph 1, the City of Downey has met its burden of proof that the amounts of the water revenue transfers to other funds were adequately supported and justified under California Constitution Article XIII D.

3. Draft Audit Report- Pages 8, 3rd Paragraph

"Figure 3 shows that the proportion paid to the replenishment district varies among the retailers we examined, and the proportion of the retailers’ rates that goes to local wholesalers is relatively small. For example, 56 cents, or 52 percent, of Downey’s $1.08 rate of per unit, would go to the replenishment district. In comparison, of ______’s rate would go to _________________________."

City Response:

The Replenishment Assessment (RA) levied by the Water Replenishment District of Southern California (WRD) for every acre-foot of groundwater pumped by water providers such as the City of Downey is adopted on an annual basis by WRD’s Board of Directors and is outside of the water providers’ control. Depending on the operations of the water provider, the annual cost for WRD’s RA can vary drastically depending upon whether groundwater makes up a small or large amount of the water providers’ water supply portfolio. Up until FY 00/01, the City of Downey used small amounts of treated imported water (purchased from MWD-member agency Central Basin Municipal Water District (CBMWD)) to augment its annual potable water supplies. However, due to the ever-rising cost of this water coupled with the potential unreliability of this source due to environmental and other issues, the City prudently moved away from the use of imported drinking water and began using groundwater to meet 100% of its potable water demands beginning in FY 00/01 to help minimize costs for its customers and to ensure a reliable source of drinking water into the future.

Unfortunately for the City of Downey, from 2000 to 2012, WRD subsequently increased its RA from $112 per acre-foot (AF) of groundwater pumped to $244/AF, an increase of 118%. As seen from the analysis provided in the draft report, the cost that the City of Downey pays WRD for its RA constitutes 52% of Downey’s per unit rate, which represents over half of the rate that Downey’s customers have to pay which is outside of the City of Downey’s control. This fact can hardly be characterized as “relatively small”, particularly when uncontrolled increases in the RA by WRD have to be borne by Downey’s customers. Obviously for those water providers which do not pump much groundwater, the portion of the rate going to WRD for payment of the RA would be much less. However, this impact to the City and its customers is quite significant and we respectfully request that this fact be stated in the report.

The City of Downey understands that this audit report focuses on the most recent five year period; however since the City had not increased its rates for 16 years until recently, in 2011, the continued increase in WRD RA costs year-after-year from when Downey transitioned to 100% groundwater in 2000 through 2012 is relevant and the most significant factor in Downey needing to raise its water rates.

4. Draft Audit Report- Page 10, 2nd Paragraph

“Groundwater can be less expensive than imported water. For instance, retailers purchasing treated imported water in 2012 from local wholesalers paid $ ______ or $ ______ per acre-foot. In contrast, a water supplier that pumped groundwater out of the Central or West Coast basin paid the replenishment district an assessment of $244 per acre-foot. If well operation and maintenance costs were $200 per acre-foot, the total cost of groundwater would be $444 per acre-foot, or ______ less than imported water purchased from ______, and ______ less than imported water purchased from ______.”
City Response:

The City of Downey agrees that groundwater is generally less expensive than imported water as previously demonstrated by the City’s move away from the use of imported water for potable water needs to 100% groundwater in FY 00/01.

Although generally less expensive than imported water, groundwater pumpers in the area have still witnessed a detrimental increase in the WRD RA costs in recent years, rising **118%** from $112 per acre-foot (AF) of groundwater pumped in 2000 to $244/AF in 2012; increases that have not been adopted in compliance with California Constitution Article XIII D (Proposition 218) and are illegal. These cost increases in WRD’s RA are subsequently paid for by groundwater pumpers’ customers such as those in the City of Downey. Further, well operations and maintenance costs can vary widely from one groundwater pumper to the next depending upon water supply system operational factors. As the scope of this audit is to determine the various reasons that affect the rates water suppliers charge, the City of Downey feels that these two issues should be expanded to include this information to provide clarity on the trends and factors that affect water customers’ rates in the region.

5. Draft Audit Report- Page 11

“Scope and Methodology

The Joint Legislative Audit Committee (audit committee) directed the California State Auditor to perform an audit to evaluate the cost of water delivery in southeastern Los Angeles County. Specifically, the audit committee directed the California State Auditor to focus on the significant factors that contribute to a water customer’s bill to identify the reasons for the rising cost of water, as well as methods to improve the cost-effectiveness of water delivery. The audit analysis the audit committee approved contained six separate objectives. We list the objectives and the methods we used to address them in Table 1.”

Page 17, Item No. 6

“Review and assess any other issues that are significant to the cost and delivery of water to Los Angeles County residents and business.”

City Response:

As more fully discussed above, the **118% increase in WRD RA costs** from $112 per acre-foot (AF) of groundwater pumped in 2000 to $244/AF in 2012, and the fact that this RA constitutes **52%** of Downey’s per unit rate provided in the report is **significant**. Neither Item No. 2 or Item 6 in Table 1 appear to clearly define

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2 As we have previously advised your office, the Los Angeles Superior Court entered an order on April 25, 2011, in City of Cerritos, et al. v. WRD, Cause No. BS 128156 (“Cities Litigation”), declaring WRD’s RA over the last four years (2006-10) to be illegal pursuant to Article XIII D of the California Constitution. The Court further ruled WRD must comply with Article XIII D before adopting any new RA. WRD has not done so. WRD adopted the 2011-2012 RA and the 2012-2013 RA without complying with Article XIII D, in complete disregard of the April 25, 2011 Order.

Again, on December 11, 2012, Judge Dau of the Los Angeles Superior Court ruled in the Cities Litigation that the Cities have a right to a refund of illegal excessive RAs collected by WRD for the period 2006-10 in violation of the California Constitution Article XIII D.
WRD’s RA as a significant factor. The City of Downey assumes it was not the intent of Table 1 to gloss over this factor, particularly considering how far-reaching WRD’s RA costs are to the millions of residents in the region, and recommends that Item No. 2 or Item No. 6 be amended to include WRD’s RA as such a factor.

6. Draft Audit Report-Page 12, 2nd Paragraph

"Specifically, we identified increases in the rates each entity charged and determined why significant increases occurred from one year to the next. Although we identified several reasons for these rate increases, the most prevalent one was that the suppliers’ own costs increased. Because suppliers base the rates they charge on the amount of annual revenue they believe necessary to cover their annual costs, when costs increase, so do rates. For example, __________________________________. Other reasons for rate increases included improving water conservation by implementing a tiered rate structure in which those consumers who use more water pay higher rates, and eliminating deficits when annual revenues are not sufficient to cover the costs of providing water."

City Response:

Although the City of Downey generally agrees with the intent of this paragraph, the use of the phrase "suppliers own costs" misleads the reader into the belief that all of these costs are generated solely by the water supplier when in fact many water suppliers’ costs are outside of its control. Typically, these outside costs are passed through from the water supplier to the water customer via water rates. For example, the dramatic increases of the RA by WRD is solely controlled by the WRD Board; electricity, recycled water, inflation, and fuel costs are all outside of a water suppliers’ control and are controlled by market forces. In the case of the City of Downey, the RA, electricity, recycled water, inflation, and fuel costs make up the majority of its costs in operating its water supply and distribution system. Downey recommends the wording in this paragraph be amended and expanded to provide clarification on these costs.

7. Draft Audit Report-Page 13, Bottom Paragraph

"Different Cost Factors and a Desire to Promote Conservation Contributed to Retailers’ Rate Increases

The water rates charged by the three water retailers we reviewed increased from 2008 through 2012. As indicated in Figure 7, the monthly cost of 20 units of water purchased from __________ from $60.64 in July 2008 to $84.05 in July 2012, an increase of $23.41 (39 percent). Over the same time period and for the same amount of water, __________’s monthly costs increased by $33.45 (50 percent), from $66.71 to $100.16. For water purchased from Downey, the monthly cost for 20 units of water increased by $15.09 (64 percent), from $23.48 to $38.57."

City Response:

The City of Downey understands the need for a basis of water rate comparisons. However the focus, as presented, appears to be on the amount of the increase and corresponding percent with no mention of the fact that Downey’s water rates are one of the lowest in the region and the State. Although the percentage rate increase appears high, it is due to the fact that the City of Downey had held its rates at the same level for 16 years. For this 16-year period, the increase in costs for water services had been subsidized by the City’s general fund. Given the significance of these two factors on the City’s water rates, the City feels these points should be included in the final report.

8. Draft Audit Report-Pages 15 (bottom) to 17
“Portions of Downey’s Water Fees May Not Be Allowable under the California Constitution

Downey’s water rates may generate funds that exceed the amount required to provide its water services, which would violate the California Constitution. Under Article XIII D of the California Constitution, which was added by Proposition 218 in 1996, a property-related fee or charge shall not be extended, imposed, or increased by an agency unless it meets certain requirements. These requirements include provisions that revenues derived from the fee or charge shall not exceed the funds required to provide the property-related service and that these revenues shall not be used for any purposes other than that for which the fees or charge was imposed. In addition, fees or charges based on potential or future use of a service are not permitted. Article XIII D also specifies that the local agency imposing a fee bears the burden of proving the fee complies with the article. In 2006 the California Supreme Court determined that a public water agency’s charges for on-going water delivery are property-related fees under Article XIII D. In other words, water fees paid by customers are subject to the requirements of Article XIII D.

Downey transferred revenues generated from water fees for uses that it was unable to sufficiently substantiate were related to water service. During fiscal year 2008-09 through fiscal year 2010-11, Downey transferred almost $1 million from its Water Fund, which is used to account for the provision of water services to residential, commercial, and industrial customers, to other government funds. Downey’s financial statements indicate that these transfers were made to provide funding for capital expenditures. When we asked Downey for specific details on the amounts transferred to its Sewer and Storm Drain Fund, which is used to account for charges collected for the upkeep of sanitary sewers and federally required drainage upkeep programs, Downey’s finance manager explained that the Water Fund paid for the costs incurred by its stormwater engineering division, which helps to ensure that runoff water entering the storm drain system is clean so that rivers and oceans are not polluted. Our legal counsel advised us that court decisions interpreting Article XIII D have not prohibited local governments from charging its customers water fees that would recoup the costs of the government’s water department on other government departments, as long as these fees reasonably represent such costs. However, Downey staff was unable to provide sufficient documentation supporting what costs the transferred amounts represented. Because Downey was unable to provide support for what costs the transferred amounts were supposed to recoup, we question the legality of these transfers.

City Response:

We incorporate by reference the response we provided in Paragraph 1 above as the City’s response to this paragraph.

9. Draft Audit Report-Pages 17 (2nd Paragraph) to 18

“...In addition, in fiscal year 2010-11 Downey transferred $3.3 million from its Water Funds to its Transit Fund, which is used to account for Downey’s city-operated bus service for senior citizens and disabled individuals and the fixed-route DowneyLINK bus system. Downey staff provided us with documents showing that the transfer was made to acquire property, in part to accommodate a possible future water treatment plant. Downey’s utilities manager stated that the transfer was made to acquire property necessary to implement water treatment facilities in the future. Downey initially couldn’t provide us with sufficient evidence supporting its recent efforts to construct such a treatment facility. For instance, although Downey’s capital improvement plan mentioned the treatment facility, the facility was not listed as a priority. Rather, Downey included it as the fourth of four priorities on its list of potential projects that could be added should funding allow. We questioned whether the funds used to acquire the property for the treatment facility could be considered fees based on potential or future use of the service, which are prohibited by Article XIII D. However, our legal counsel did not identify any case law that directly addressed this issue. Moreover, other case law suggests that water fees could be used to pay for long-term capital expenditures. Regardless, in December 2012, the Downey city council enacted a resolution authorizing the city manager to apply..."
for and submit all required documents to obtain funding for the treatment facility. This resolution mitigated our concern that the fees used to purchase the land were based on a potential or future use of water services."

City Response:

The City of Downey finds the presentation of the above issue in its current form confusing and misleading. At the onset, there is mention of a transfer to the Transit Fund and inclusion of a long definition of what the Transit Fund is with no explanation as to the reasoning for such a transfer and the relationship of the Transit Fund to this property acquisition as provided by the City. Further, the second and third sentences are repetitive. The chief reason for transferring among funds for such a project is for ease of transaction where one fund operates in essence, like a clearinghouse. Additionally, the treatment plant as currently proposed, would occupy the existing Utilities Yard property requiring the existing offices, parking, vehicle/equipment/material storage, and other displaced by the treatment facilities to be rebuilt elsewhere. Space occupied by the displaced facilities would take up approx. 90% of the properties acquired by this transaction which is greater than the percentage of the property acquisition funds paid by the water fund (approx. 80/20). However, since the displaced facilities would need to be rebuilt, the intent was to consolidate operations on the newly acquired property to allow space for transit vehicle parking. Given the relationship of the two funds to this project, the first part of this paragraph as described above, is misrepresented and should be amended to provide clarification.

In the same paragraph, your office states that Downey initially could not provide the Auditor with sufficient documents supporting its recent efforts to construct such a treatment facility. This statement is inaccurate. Over the course of the 6-month audit process, the City provided the following documents directly relevant to the efforts made by the City in 2008, 2009, 2010, 2011 and 2012 to move the water treatment plant project forward:

1. April 9, 2008 letter from Representative Lucille Roybal-Allard that the U.S. House Committee on Transportation and Infrastructure would consider the “Water Resources Development Act bill;
2. A copy of House of Representative Bill (H.R.) bill 1738 entitled “Downey Regional Water Reclamation and Ground water Augmentation Project” which would be the funding vehicle for Downey’s waste treatment plant;
3. Downey Delegation Schedule dated April 20-12, 2009 to lobby in favor of H.R. 1738;
4. November 9, 2010 Downey City Council staff report approving the acquisition of the properties at 9300 Stewart & Gray Road and a portion of 11921-12007 Woodruff Avenue, Downey for the water treatment plant;
5. Resolution No. 12-7386 dated December 11, 2012 reaffirming the Downey City Council’s support for the water treatment plant project and directing the City Manager to secure funding for the project.

These documents provide evidence that:

- the City made a request in 2008 pursuant to the Water Resources Development Act funding for the project;
- the City made requests for appropriations with our federal legislators in 2009 to help fund the project;
- the City staff worked on legislation (HR 1738) to the House Committee on Natural Resources in 2010 that would have provided funding for the project;
- the City completed the purchase of the land for the project in 2011; and
- the City Council reaffirmed its support and commitment for the project at the Council Meeting in December 2012, including authorization for the City Manager to secure funding for the project.
The last part of the paragraph explains that there is lack of any case law addressing your office’s concerns regarding the use of Water fees to partially acquire property for the water treatment plant. Your office also recognizes that there is support in case law which allows water fees to be used to pay for long-term capital expenses. Given the nature of the law and the documentation and clarification provided to your office, the City questions the reasoning for inserting as the heading to this paragraph: “Portions of Downey’s Water Fees May Not Be Allowable under the California Constitution.” The City’s position is that this heading is misleading in light of your office’s acknowledgement that there is no case law that would lead your office to conclude that the City’s use of Water fees for the partial acquisition cost for the property was in violation of California Constitution Article XIII D.

10. Draft Audit Report-Page 24

“Recommendations

To ensure that it can meet the burden of proof that its water fees comply with Article XIII D of the California Constitution, Downey should be able to provide, upon request, documentation that all transfers out of the Water Fund are for water-related purposes. Such documentation should be detailed and understandable to the layperson.”

City Response:

The City of Downey has already met the burden of proof that the amounts of the water revenue transfers to other funds were adequately supported. This burden of proof was thoroughly provided in the form of tables, budget documents, expenditure reports, and statements to the Auditor supporting these transfers. This burden of proof is also provided each year during the annual budget process where the Council approved policies were to fund costs of the Sewer and Storm Drain Fund since the Water Fund a) was receiving direct benefits from Storm Water Engineering efforts in the form of capturing and storage of runoff during dry and wet weather conditions through development requirements and City projects to raise the local water levels which benefit the City’s groundwater wells, as well as the runoff compliance costs caused by the City’s water system since all dry weather flows emanate from the City’s source water; and b) was receiving direct benefits from the Sewer and Storm capital improvements in the form of preventing contamination of the City’s groundwater from leaking sewer pipes/facilities. The City has been very cooperative in thoroughly answering questions related to these transfers and such information should be reflected in the audit report should this item continue to be included.

Lastly, we note that your office submitted a material change to its recommendations in the draft report a day before this formal response was due to your office. Our position is that the material change did not give the City sufficient time to respond to the draft report and that the City should have been given additional time to prepare this response.

If you have any questions regarding the City’s response to the draft report, you may contact me at (562) 904-7282 or at joskoui@downeyca.org.

Sincerely,

(Signed by: John Oskoui)

John Oskoui
Assistant City Manager/
Director of Public Works
Comments

CALIFORNIA STATE AUDITOR’S COMMENTS ON THE RESPONSE FROM THE CITY OF DOWNEY

To provide clarity and perspective, we are commenting on the City of Downey’s (Downey) response to our audit. The numbers below correspond to the numbers we have placed in the margins of Downey’s response.

When preparing our audit report for publication, page numbers shifted. Therefore, the page numbers that Downey cites throughout its response do not correspond to the page numbers in our final report.

Downey’s response quotes our draft report stating that the city had transferred almost $1 million from its Water Fund to other funds during fiscal years 2008–09 through 2010–11. However, the draft report was revised to state that our audit work regarding these transfers, including our discussions with Downey, related to fiscal years 2007–08 through 2010–11. Pages 2 and 27 of our final report reflect this change.

To clarify our point regarding Downey not providing sufficient evidence regarding certain transfers from its Water Fund, we revised a portion of the text on pages 2 and 28 of our report. These revisions did not affect our conclusions concerning this issue.

Our statement is accurate and we stand by our text. Downey takes issue with our conclusion that, in our auditor opinion, the city could not substantiate that its transfer of nearly $1 million from its Water Fund was for water-related purposes. As we indicate on page 27 or our report, the California Constitution places the burden of proof on Downey to demonstrate that its fees bear a reasonable relationship to the cost of providing water-related services. Although only a court of law can decide upon the legality of Downey’s fees, the point of our critique and resulting recommendation is that Downey needs to maintain clearer documentation specifying the methodology and rationale supporting the amounts transferred so it can more readily defend its actions to water ratepayers. Beginning in early November 2012, we had asked Downey to provide us with the methodology and/or calculations it had used to determine the amounts transferred. Although Downey provided us with budget documents and audited financial statements, these documents did not explain why the nearly $1 million in transfers reflected costs specifically attributable to its water system. During the audit, Downey provided only high-level verbal explanations, such as those in its response to the audit, which in our opinion does not provide us with sufficient and
appropriate evidence to conclude on whether Downey’s transfers consistently reflected water-related costs as opposed to other city expenses.

Downey states that our report makes a blanket statement questioning generally its transfers from its Water Fund. Our report makes no such statement. In fact, as we mention on page 28 of our report, our legal counsel advised us that court decisions interpreting Article XIII D of the California Constitution have not prohibited local governments from charging its customers water fees that would recoup the costs of the government’s water department on other government departments, as long as these fees reasonably represent such costs.

Downey also states that we did not question all water fund transfers. During numerous telephone calls involving Downey and staff of the California State Auditor’s office, we discussed examples of the types of transactions we remained unconvinced were for water-related purposes. We did not state nor imply that these were the only transactions we were questioning.

Downey believes that it has more than met its burden of proof that the amounts transferred to other funds were adequately supported. Despite the city’s belief, we stand by our statements on pages 27 and 28 of our report that, in our auditor opinion, Downey transferred revenues generated from water fees for uses that it was unable to sufficiently substantiate were related to water service.

Downey’s statement on page 46 of our report that the amendment to our recommendation did not give the city time to respond to the draft report is perplexing. This statement is inconsistent with the statement on page 40 of our report that its comments respond to the amended recommendation and not the language appearing in the original draft report.

Downey’s response includes quotes from our draft report that contained redactions. We redacted portions of the draft report sent to Downey to maintain the confidentiality of certain information provided by other entities included in our audit.

Downey misunderstands this sentence of our report. We did not characterize the Water Replenishment District of Southern California’s (replenishment district) share of Downey’s rate as relatively small. As we state on page 8 of our report, the proportion of the retailers’ rates that goes to local wholesalers is relatively small. As Figure 3 on page 9 of our report shows, no part of Downey’s rate goes to local wholesalers.
Downey’s response cites an ongoing court case and concludes with a statement that the replenishment district’s assessment (i.e. the fee it imposes for pumping groundwater) is illegal. According to the replenishment district’s general manager, while a trial court has determined that the replenishment district’s imposition of replenishment assessments violated the California Constitution, the court has not yet assessed damages. Furthermore, according to documents pertaining to the replenishment district, it intends to appeal the trial court’s determination. Also, because of this ongoing litigation and in accordance with generally accepted government auditing standards that cautions against interfering with such ongoing legal proceedings, we performed no audit work related to the legality of the replenishment district’s assessment.

Downey’s response takes issue with the Scope and Methodology section of our report, claiming that the replenishment district’s rising assessment should be considered a significant factor. We believe our Scope and Methodology table accurately describes our audit approach. Further, the scope of the audit as approved by the Joint Legislative Audit Committee did not include a review of how the replenishment district sets its rates. Nevertheless, on page 27 of the audit report we provide the reader with some context for one of the replenishment district’s more recent rate increases and its cause.

Contrary to Downey’s assertion, our report is not misleading. Our report clearly states on page 8 that the rates consumers pay to retailers help cover the costs of the various water agencies along the water supply chain. For example, Figure 3 on page 9 shows our estimate that more than half of Downey’s water rate is attributable to costs imposed by the replenishment district. The paragraph that Downey takes issue with in its response is a summary paragraph from our draft report. We stand by the full text as written in our audit report.

Downey’s criticism of our report is unwarranted. Our report recognizes Downey’s lower water rates, as illustrated in Figure 3 and Figure 7 on pages 9 and 25, respectively. In Figure 3 we estimated that Downey’s costs were $1.08 per hundred cubic feet, or roughly three times less than the amounts charged by the other two retailers we reviewed. Similarly, Figure 7 shows that for a given amount of water, Downey’s monthly water bill is significantly less than the two other retailers included in the audit. Finally, on pages 26 and 27 of the report, we discuss Downey’s rationale for recently increasing its water rates. As such, we stand by our report’s text.
Contrary to Downey’s claim, our text is clear and does not misrepresent the facts associated with Downey’s transfer of $3.3 million from its Water Fund. The relevant facts are, as we state on page 28 of our report, that Downey transferred $3.3 million from its Water Fund to its Transit Fund and that the transfer was made to acquire property, in part to accommodate a possible future water treatment plant. Downey’s discussion of other detailed information in this paragraph of its response—for example, the relationship between its Water Fund and Transit Fund—is irrelevant.

We stand by the statement in our report that Downey could not initially provide sufficient documents supporting its efforts to build a water treatment facility on the acquired property. On page 28 of our report, we stated that although Downey’s capital improvement plan mentioned the treatment facility, the facility was not listed as a priority, and that Downey included it as the fourth of four priorities on its list of potential projects that could be added should funding allow. Other documents related to the treatment facility provided during the audit were dated from April 2008 through April 2011. Further, a November 2012 e-mail to us from Downey’s utility manager stated that the city took advantage of an opportunity to acquire the land to, among other things, implement water treatment facilities should they be needed in the future. Based on this information, we reasonably questioned Downey’s inability to provide sufficient evidence of its recent efforts to construct the facility. Our concern that the water fees used to purchase the land were based on a potential or future use of water services, and therefore may be inappropriate under the California Constitution, was not mitigated until the Downey city council enacted a resolution in December 2012 authorizing the city manager to apply for and submit all required documents to obtain funding for the treatment facility. We clearly make this point on page 28 of our report.

Downey incorrectly claims that the heading on page 27 of our report is misleading. We stand by our heading as written, which concludes that portions of Downey’s water fees may not be allowable. Based on our description of the transfers from Downey’s Water Fund to its Sewer and Storm Drain Fund on pages 27 and 28 of our report, we believe we have a basis to question the appropriateness of these transfers. Further, if challenged, a court of law would determine the legality of Downey’s use of water fees in these transfers.
cc: Members of the Legislature
    Office of the Lieutenant Governor
    Little Hoover Commission
    Department of Finance
    Attorney General
    State Controller
    State Treasurer
    Legislative Analyst
    Senate Office of Research
    California Research Bureau
    Capitol Press
February 11, 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 90065-0153


Dear Chairman Foley and Members of the Board:

Before we address the comments we have on draft Appendix A, we have questions we would appreciate staff addressing at today’s meeting and in a detailed written report to the board at next month’s meeting of the Finance and Insurance Committee. The questions are prompted by the disclosure in the PowerPoint presentation (“Part 1”) posted on the MWD website, that MWD ratepayers will be funding as much as $20 million in termination penalties associated with the proposed “financing plan” for which these bonds are being sold.

1) What have MWD’s savings or “gains” been over the course of the entire time it has invested in swaps? Please include a summary of all costs associated with these transactions.

2) What are the net cumulative savings or loss since inception?

3) What swaps remain outstanding, and what is MWD’s potential exposure to termination, either by MWD or the counter-parties?

There are many new board members who were not on the board when MWD’s September 11, 2001 board resolution was passed authorizing the execution of interest rate swap transactions and related agreements according to a master swap policy. This resolution and subsequent amendments are described on page A-66. We request a detailed report to the board on the swap policy and on the MWD Board’s broader investment policy for the protection of water ratepayer funds. We believe that it is important for the Finance and Insurance Committee and Board of Directors to receive a more robust and detailed report of...
these activities, as well as to look at the Board’s investment policies and consider whether they should be updated or changed to be more conservative.

**REVIEW OF DRAFT APPENDIX A**

We have reviewed February Board Memo 8-1, including its attachments, and determined that 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 have also reviewed and taken into account the PowerPoint presentations (“Parts 1 and 2”) posted on the MWD web site. We appreciate certain disclosures that have been added to the draft Official Statement, noted below, and, that the staff is taking additional measures to inform the board during the Finance and Insurance Committee meeting of its responsibilities associated with its review and approval of draft Official Statements. However, as we have stated in prior correspondence, we believe that in addition to disclosure of material facts, it is also required that information be presented in a manner that tells the “whole truth,” that is, in a manner that is not misleading. In addition to specific factual issues that have been raised in the past and not addressed by MWD, this is where we believe MWD’s Offering Statement falls short.

**EDITS THAT ADDRESS CONCERNS STATED IN PRIOR LETTERS**

We attach and incorporate by reference our letters to you and Assistant General Manager/Chief Financial Officer Gary Breaux dated November 5, 2012 and October 8, 2012, respectively (Attachments 1 and 2). We wish to acknowledge the following improvements in the draft Official Statement, which respond in small part to concerns stated in prior letters. All page references are to Appendix A dated January 30, 2013, to the draft Official Statements for Metropolitan’s Water Revenue Refunding Bonds, 2013 Series A, B and C [marked to show changes from 10/24/12 draft].

A-12: The disclosure of preliminary cost estimates for the BDCP and the 25% share that MWD anticipates it would pay.

A-17: The disclosure that the 80,000 acre-feet of conserved water from the lining of portions of the All-American and Coachella Canals is actually delivered to the San Diego County Water Authority.

A-31: The disclosure that the Los Angeles Department of Water and Power has filed litigation challenging environmental mitigation requirements relating to its Owens Valley imported water supply; and, acknowledgement of its need to purchase an equivalent amount of replacement supplies from MWD.

A-58: The disclosure that, under Proposition 26, taxes imposed by a special district such as MWD are subject to approval by two-thirds of the voters voting on the ballot measure for
authorization.

With the exception of these additions, the concerns expressed in our letters, Attachments 1 and 2, have not been addressed.

**ADDITIONAL COMMENTS AND QUESTIONS ON THE APPENDIX A DATED JANUARY 30, 2013, TO THE DRAFT OFFICIAL STATEMENT FOR METROPOLITAN’S WATER REVENUE REFUNDING BONDS, 2013 SERIES A, B AND C [MARKED TO SHOW CHANGES FROM 10/24/12 DRAFT]**

A-10: *State Water Project operational constraints.* Why is the last sentence of the first paragraph being deleted (the information is not outdated and remains relevant to July 2012 storage levels through July 2012)? Also, please reconcile the numbers reported in this paragraph with those contained in this month’s Water Planning and Stewardship Committee, Item 6a, PowerPoint Presentation slide 21 of 27, Attachment 3.

A-18: *Sale of water by Imperial Irrigation District to SDCWA and MWD Exchange Agreement.* The last sentence should be updated and corrected to reflect that IID did in fact meet its 2012 conservation obligation of 90,000 acre-feet, and, also delivered the additional 16,722 acre-feet of conserved water which MWD agreed to exchange and did exchange in 2012.

A-26: *Discrepancies between the draft Official Statement and MWD’s January 2013 WSDM staff report to Board of Directors RE MWD’s storage capacity and actual water in storage.* The draft Official Statement reports MWD’s storage capacity to be 113,000 acre-feet lower and water in storage 4,000 acre-feet higher than MWD January 2013 Water Surplus and Drought Management report to the board of directors, Attachment 4. Please clarify the discrepancies.

A-33: *Replenishment and the sale of discounted water.* It would be misleading to delete the discussion about a new storage program to replace the Replenishment Service Program unless these plans have in fact been abandoned by MWD and the member agencies. Just a few months ago, before the “rate refinement” process was terminated, MWD and the other member agencies had identified the sale of discounted water as a “top priority.” See Attachment 2, page 3 at A33 and A-52 and Attachment 1, page 6 at A-53.

A-44: *Growth in number of unbudgeted MWD employees.* Based on the edited numbers, MWD has added 93 employees since last October. Based on the presentation to the Board Budget Workshop on February 12, 2012, this number exceeds the budgeted employees by 45 employees (see slide, Attachment 5). What is the source of funding being used to pay the costs of the unbudgeted positions?

A-48: *Revised (“extended”) purchase orders as evidence of MWD’s projected water sales revenues.* We believe it is misleading to discuss the revised Purchase Orders in the context of disclosures about MWD’s projected water sales revenues, for the reasons described in the
Chairman Foley and Members of the Board  
February 11, 2013  
Page 4

letter from the Water Authority’s General Counsel to MWD’s General Counsel dated December 27, 2012, Attachment 6. Given that at least 19 of the 22 member agencies executing the revised Purchase Orders had already met the minimum revised purchase order commitment even before the extension, the revised Purchase Orders provide no meaningful assurances to investors about MWD’s future sales revenues.

A-50: Source of funding to pay SDCWA to the extent it prevails in the litigation. MWD has not changed the following statement: “If Metropolitan’s rates are revised in the manner proposed by SDCWA in the complaint, other member agencies may pay higher rates unless other actions are taken by the board.” The Water Authority inquired about the basis of this statement when it was changed by MWD, because it is inconsistent with the claims being published by many MWD member agencies and at times by MWD itself. See Attachment 2, page 3 at A-50. Neither MWD nor its member agencies has explained why this change was made to the last draft Official Statement, which previously stated that, “If Metropolitan’s rates are revised in the manner proposed by SDCWA in the complaint, other member agencies would pay higher rates.” The language in the current draft Official Statement is inconsistent with the expectations described in the Fitch ratings that have just been assigned to MWD bonds:

CASH RESERVES FOR RISK

The unrestricted cash amount above excludes additional restricted cash of $67.5 million that is set-aside for disputed amounts paid by the San Diego County Water Authority (SDCWA), which are the subject of ongoing litigation. **To the extent the litigation is decided in favor of SDCWA and Metropolitan Water District must make a payment to SDCWA, Fitch anticipates that any settlement would be collected from other member agencies in a timely manner.** The litigation relates to the rate methodology used to allocate costs between members. (Emphasis added.)

The expected source of money that would be used to pay SDCWA is a material fact; at a minimum, it is something we believe an investor would be interested in knowing when considering whether to invest in MWD bonds.

A-51: More on MWD purchase orders. See comments above at A-48. In addition, MWD should disclose during the discussion at A-51 that its largest customer (see footnote 1 at page A-2) – the Water Authority – signed the revised Purchase Order under protest, and why. Further, MWD should note that it rejected SDCWA’s execution of the revised Purchase Order. See Attachment 7, letter from MWD General Counsel to SDCWA General Counsel dated January 4, 2013.

A-52: Inaccurate, ex post facto characterization of how Replenishment Service Program was operated. The edits to the first sentence of the Replenishment section change the prior statement describing program objectives to an inaccurate statement of fact about purported
benefits of the sale of discounted water as replenishment. See discussion at Attachment 1, page 6 at A-53 and Attachment 2, page 3 at A-33 and A-52.

A-55: MWD’s financial reserve policy, the use of “unrestricted reserves” as “collateral” and failure to establish a separate interest bearing account for SDCWA litigation deposits. It is not possible to confirm from the information and commingled descriptions provided at A-55 whether MWD is in compliance with its financial reserve policies. One thing that is clear is that MWD has failed to establish a separate interest bearing account for SDCWA litigation deposits as required by the Exchange Agreement. The very purpose of the requirement of a “separate interest-bearing account” was to restrict MWD’s use of those monies for other purposes. MWD has also failed to explain how reserve balances that are held as collateral can be described as “unrestricted.” See Attachment 1, page 8 at A-81. No response to this question has been provided by MWD.

A-72: Inclusion of Bay Delta Conservation Plan construction costs in projected costs of MWD for State Water Project water. Please identify what construction costs have been included in the 2016 and 2017 projected costs for anticipated construction of additional State Water Project facilities.

A-74: Failure to raise rates to fund pension and Other Post Employment Benefits (OPEB) liabilities. As of January 1, 2011, MWD’s combined unfunded retiree health care obligation and unfunded pension liability is at least $757 million. When this number is next updated, the number will likely approach the $1 billion mark. Although there are many disclosures of fact in the draft Official Statement, the burden of this liability on future water ratepayers and the cost of water are not described. MWD’s plan to “begin OPEB funding above annual pay-as-you-go amounts with $5 million in the fiscal year 2012-13 budget” and statement that it “intends” to increase this amount by $5 million per fiscal year to an annual funding amount of $25 million beginning in fiscal year 2016-17 defies the reality of other statements that it will, at the same time, begin construction of the BDCP and hold rate increases to 3%. This estimate pales in comparison to MWD’s average annual rate increases of 5.6% over the past 30 years (1984-2014), and its average annual rate increases of 7.9% over the past 10 years (2004-2013). It is difficult to imagine that MWD will impose far lower annual rate increases, while at the same time invest billions of dollars more on its Bay Delta water supplies and begin modest payments to its unfunded OPEB liability. Further, given that the MWD board has not been willing to raise water rates now to pay for these liabilities, one is left to wonder why it will be willing to do so in the future at a time when MWD’s BDCP costs are substantial.

A-80: Management’s projections and assumptions concerning future events and circumstances that may impact MWD’s revenues and expenditures are unreasonable. Based on all of the detailed comments we have provided in regard to past draft Official Statements, and other resource planning and financial issues at MWD, we do not believe that management’s projections and assumptions as described in the draft Official Statement are reasonable. MWD’s continued reference to long-outdated planning documents in its Official
Statement is a matter of concern to us and should be a matter of concern to investors, not the least of which is the 1999 Long Range Finance Plan which even MWD has abandoned as a planning document for board planning purposes. Aside from all of the data, simple common sense suggests that there is no way that MWD can do everything that it says it will do beginning in 2016 (IRP projects, construction of BDCP and increase payments to OPEB) and at the same time, hold rate increases to 3 percent – all at the same time its sales are down 25% and its member agencies are constructing and planning more local water supply projects throughout Southern California to reduce their demand for increasingly expensive imported water supplies.

For the reasons stated above, the Water Authority’s delegates cannot support staff’s recommendation to authorize execution and distribution of the Official Statement.

Sincerely,

Keith Lewinger
Director

Vincent Mudd
Director

Fern Steiner
Director

Doug Wilson
Director

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

Attachment 1: Water Authority letter dated November 5, 2012 Re MWD OS
Attachment 2: Water Authority letter dated October 8, 2012 Re MWD OS
Attachment 3: MWD February 2013 WP&S Committee item 6a, PowerPoint Slide 21
Attachment 4: MWD January 2013 Water Surplus and Drought Management Report Attachment 1
Attachment 5: MWD Slide Dated February 13, 2012, Budget Workshop
Attachment 6: Water Authority General Counsel letter dated December 27, 2012 to MWD General Counsel re Purchased Order
Attachment 7: MWD General Counsel letter dated January 4, 2013 to Water Authority General Counsel re Purchase Order

1 It is unclear why the edits would be made to an October 24, 2012 draft rather than the last Official Statement actually used by MWD. We assume that the October 24, 2012 draft is in fact the last Official Statement issued by MWD; to the extent that is not the case, we reserve the right to submit additional comments. Please clarify this point.

2 Friday, February 8, 2013 3:37 pm EST.
November 5, 2012

John (Jack) V. Foley and
Members of the Board of Directors
Metropolitan Water District of Southern California
P. O. Box 54153
Los Angeles, CA 90065-0153

RE Board Memo 8-1: Authorize the execution and distribution of the Official Statement in connection with the issuance of the Water Revenue Refunding Bonds, 2012 Series G - OPPOSE

Dear Mr. Foley and Members of the Board:

We have reviewed Board Memo 8-1, including its attachments, and determined that 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 have also reviewed and taken into account the October 25, 2012 response from the Chief Financial Officer to our October 8, 2012 letter commenting on the changes he made to the last Revised Appendix A – many of which could have been, but were not, made available to the board members for review prior to the distribution of that Official Statement. We appreciate the opportunity to engage in a dialogue on these issues, if only through correspondence.

THE CHIEF FINANCIAL OFFICER’S OCTOBER 25 LETTER

We will respond to the points raised in Mr. Breaux’s October 25 letter in the order they were presented (headings ours).

Duty to disclose material information. We agree that Metropolitan’s offering statements are prepared to give investors material information about Metropolitan and its bond offerings. However, in addition to disclosure of material facts, it is also required that the information be presented in a manner that tells the “whole truth,” that is, in a manner that is not misleading. In addition to the specific factual issues we have identified in past correspondence, this is where we believe Metropolitan’s offering statements fall short. As one specific example (others have been identified in past letters on this subject), while Metropolitan discloses that none of its customers are required to purchase any water from Metropolitan, it does not tell the “whole truth” about its reduced sales, the nature and extent of local water supply development that is occurring throughout Southern California, or, that Metropolitan itself is so worried about its own reduced sales that it is engaging in a public relations campaign to try to impede local water supply development – at least here, in San Diego.
We do not agree that Appendix A “includes primarily historical information.” Or, that Metropolitan’s budget documents, resources planning documents and financial reports may be relied upon as a reasonable basis of future projections stated in the offering statements where those – materially outdated – documents are inconsistent with actual facts. By the measure described in Mr. Breaux’s letter, actual facts would be dismissed as “speculation” if those facts are inconsistent with Metropolitan’s planning documents. We have in past correspondence provided you and the other board members and staff many details why we believe Metropolitan’s fundamental planning documents are at best, materially outdated. All of these letters have been provided to you and the other board members and the complete inventory of letters may be accessed, as this letter may be, at www.MWDFacts.com.

Conservation “commitment” to the BDCP. Mr. Breaux appears to be saying that 1) Metropolitan has, indeed, made a “commitment” and 2) that it was made when the board adopted its Integrated Resources Plan (IRP), therefore, no further board action required. To argue that such a “commitment” was made because it is “consistent with the IRP and planning goals approved by the board” calls into question what the legal effect is of board adoption of the IRP.

If Metropolitan is contending that a “commitment” was made to conserve 700,000 acre feet of water beyond the 20x2020 retail mandated conservation savings in its IRP, then a different set of issues emerges, not the least of which is the need for CEQA compliance.¹ We ask again that you provide detailed information to the board of directors regarding this “commitment,” including what share of the 700,000 acre-feet of “additional” conservation is attributable to Metropolitan and how this will be factored into Metropolitan’s water resources plans and financial projections.

Changes to the official statement regarding the Quantification Settlement Agreement (QSA). Metropolitan changed language in the offering statement that had been presented in numerous prior bond offerings. The sole basis for those changes was to conform the language to its own new litigation theories. The Water Authority provided specific changes back to the prior language – which was consistent with the QSA agreements – but those changes were not accepted by Metropolitan.

Regarding the offering statement’s failure to adequately describe what would happen if the QSA agreements were interrupted, Metropolitan is fully able to describe what the impacts would be

¹ The Water Authority has advocated for an update to Metropolitan’s IRP, to take into account materially changed circumstances since the time the IRP was adopted by the board. Now, as a result of a recent court decision, Metropolitan must make its IRP more certain if it expects water suppliers to rely upon it in making water supply assessments associated with future development. See Preserve Wild Santee v. City of Santee, 2012 WL 5077156 (Cal.App. 4 Dist.) (Cal.App. 4 Dist., 2012) or 12 Cal. Daily Op. Serv. 11,906, 2012 Daily Journal D.A.R. 14,541. In its current form, the IRP is not a reasonable basis for projecting water resources or the need for water resources because it is not grounded in a reasoned estimate of future demand, and does not even purport to “account” for the future water supplies that will be developed in order to meet that demand. Instead, it promotes a “do everything” approach without taking into account what the cost would be or the likelihood of stranded investments.
under the existing QSA agreements. No one is claiming that there couldn’t be negotiations or asking Metropolitan to speculate what the outcome of those negotiations might be.

Possibility that “all” future Southern California water supplies will be provided by Metropolitan. Based on your own explanation, the edit should be made to delete the phrase, “if any.”

Discrepancy for standard of reporting local water supply development. Mr. Breaux’s response to our letter does not address the issue we raised asking why the standard of disclosure of local water supply development for the City of Los Angeles is based upon its Urban Water Management Plan (UWMP), while for other agencies, including the Water Authority, the standard of disclosure Metropolitan is using is whether projects are “producing water or are under construction at the time a water sales projection is made.” See our August 20, 2012 letter to Metropolitan RE: Board Memo 8-1 (OPPOSE), section A-28 – Regional Water Resources, at page 4 (the August 20 letter). We believe investors would want to know what plans all Metropolitan’s member agencies have to buy less water from Metropolitan in the future, not just the City of Los Angeles. This is especially important information to be provided for the Water Authority, because it is Metropolitan’s largest steady water purchaser.

Our letter did not dispute that the Los Angeles Aqueduct is a significant source of water supply within Metropolitan’s service area. Nor did we dispute that certain disclosures are made about plans by the Water Authority to reduce its purchases of imported water from Metropolitan. What we asked is that Metropolitan “connect the dots” by making these disclosures in the appropriate sections of the offering statement regarding impacts on sales and revenues. See the August 20 letter, section A-28 – Regional Water Resources, at page 4.

LA-AVEK turnout. We agree that the “not-to-exceed” amount is a fact relevant to investors, however, the agreement itself does not contain such a limitation. That’s precisely why we were concerned with Metropolitan’s edits to the offering statement deleting the word “limits.” We renew our request for an updated board report on this project and the amount of and limitations on anticipated reduced sales by Metropolitan when it is implemented.

Description of the IID-SDCWA water transfer. We have commented many times previously on how misleading it is to describe the provision of transportation and exchange services as the “sale of water” by Metropolitan in most contexts of its offering statement. While it is true that the fact of the water transfer is disclosed, the offering statement is misleading because it reports San Diego’s purchase of water from IID as a water sale by Metropolitan. See the August 20 letter at page 1, Reduced Sales.

Metropolitan Sales Projections. There are a number of problems with Mr. Breaux’s description of Metropolitan’s process for estimating water sales that are then used in “MANAGEMENT’S DISCUSSION OF HISTORICAL AND PROJECTED REVENUES AND EXPENDITURES.” We have described the problems in past letters² which may be viewed at www.MWDFacts.com. A short summary is

² See, as an example, September 10, 2012 letter RE Update on “Rate Refinement” (Board Information Item 7-b); August 16, 2012 letter RE Rate Refinement Workshop and July 9, 2012
that Metropolitan’s evaluation of six agencies\(^3\) showed its demand projections to be lower than the member agency projections in DRY years (an important fact not mentioned by Mr. Breaux in his letter). We do not disagree with that conclusion. However, in AVERAGE years, the member agency forecasts are LOWER than Metropolitan’s forecast. For purposes of disclosures in Metropolitan’s offering statements estimating future sales and revenues, a comparison of AVERAGE demands is much more informative to investors than a comparison of the occasional single or multiple dry year scenario. This is especially so since Metropolitan has also failed to “connect the dots” for investors to explain how its rate structure currently allows agencies to pay for water only in dry years when they need it, or that its failure to account for or properly allocate the cost of this dry-year capacity during average and wet years is one of the issues being challenged in the San Diego rate litigation.

Our past letters have raised two other critical facts not taken into account by Metropolitan or Mr. Breaux’s letter: (1) Metropolitan’s forecasted demands have decreased significantly in every iteration of its UWMP; and (2) Metropolitan has excluded from its UWMP plan significant local supplies that members are NOW developing. These projects include but are not limited to the Groundwater Reliability Improvement Program (GRIP) being developed by the Water Replenishment District of Southern California, the Carlsbad seawater desalination project being developed by the Water Authority, and the water transfers now being planned by the Los Angeles Department of Water and Power in order to fill the aqueduct connection authorized by Mr. Gastelum. If Metropolitan’s “resources plan” included even a portion of these and other water supplies its customers are NOW developing, its future water sales would be greatly reduced.

*Replenishment rates.* The edits made to the offering statement do not address the fundamental problem that a significant portion of Metropolitan’s projected water sales depend on the availability of discounted water – whether cast as a discounted replenishment water rate or as a new “incentive” based program. As we have pointed out in prior letters, it is inherently misleading for Metropolitan to report on the basis of “average” sales and “average” water prices that bear no relation to the actual economic factors investors need to make informed decisions about Metropolitan’s future water sales and revenues.

*PAYGo funding.* Accurately describing the reason why Metropolitan’s actual pay-as-you-go funding has consistently been less than *budgeted* does not require speculation – it is because Metropolitan’s sales and revenues have consistently and substantially failed to meet budget.

*Alleged cost-shifting.* Metropolitan and the rest of its member agencies have contended for years

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\(^3\) Mr. Breaux refers to a “comprehensive analysis of all 26 member agencies,” however, we are not aware of any such comprehensive report. If one exists, we request to be provided with a copy and will reassess the facts in regard to this issue. We are also unaware of any comparison of AVERAGE Urban Water Management Plan demands for all or even the six agencies and again request to be provided a copy if one exists.
that if Metropolitan’s rates were revised as suggested by the Water Authority, it would unfairly “shift costs” to other member agencies. Please provide us with a copy of the financing team comments that have now questioned that premise and that were the basis of the edits made to the last offering statement.

*Water purchase estimates for State Water Project.* We disagree that the edits Metropolitan recently discovered should be made to the long-standing language of the offering statement are mere “wordsmithing.”

**EDITS TO THE OCTOBER 24, 2012 DRAFT OFFICIAL STATEMENT**

The following specific comments address the most recent set of edits to the draft Official Statement, dated October 24, 2012. We incorporate by reference all of the prior comments made on the Official Statement, most of which have not been addressed by Metropolitan.⁴

**A-3 – Integrated Water Resources Plan**

The description added of the 2010 IRP update as an “adaptive management approach” is misleading. The IRP estimated water sales numbers are substantially higher than those used in Metropolitan’s Urban Water Management Plan or disclosed in its offering statements. As noted in the August 20 letter at page 1, *Reduced Sales*, Metropolitan has finally reduced its water sales projections by 300,000 AF for FY 2013, 400,000 AF for FY 2014 and 350,000 AF for FY 2015 from those predicted in September 2010. However, these flawed numbers are still contained in Metropolitan’s IRP and Metropolitan’s IRP is still being used as the basis of its water resources planning and spending decisions. Calls to update the IRP or adjust spending decisions to *adapt* to these reduced demands have gone unheeded. Apparently, Metropolitan believes that its water sales can only “adapt” to increase, but never to decrease. This is a materially flawed planning assumption that is inconsistent with known facts.

Metropolitan should also include in the discussion of its IRP implications of the recent *Preserve Wild Santee* case noted in footnote 1 of this letter.

**A-18 – Sale of Water by the Imperial Irrigation District to San Diego County Water Authority**

Add to the last sentence of the first full paragraph at page A-19, “and Metropolitan has agreed to convey and exchange to the Water Authority in 2012 an additional 16,722 acre-feet of Conserved Water, regardless of the pending dispute between the parties as to whether the water was actually made available in 2011.”

**A-31 – Los Angeles Aqueduct**

Disclosure should be made of the litigation that the City of Los Angeles has recently filed challenging its Eastern Sierra environmental mitigation obligations. The implications of this litigation should also be added at page A-12 discussing the open-ended “decision tree” process for determining

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⁴ Past comments were provided in 2012 letters dated August 29, August 20, June 11, April 9 and February 13. All letters may be viewed at [www.MWDFacts.com](http://www.MWDFacts.com).
environmental mitigation requirements associated with the BDCP.

**A-34 – Seawater Desalination**
The offering statement has embedded Metropolitan’s disclosure of the Water Authority’s Carlsbad seawater desalination project in the discussion about its own subsidy program in a manner that is misleading and creates the impression that implementation of the Water Authority’s project depends upon execution of the original multi-party incentive agreement in which Metropolitan was a party. Metropolitan is not a party to the Water Authority’s draft water purchase agreement with Poseidon. We suggest deleting the following sentence that was added to the middle of the last paragraph on page A-34, “In late September 2012, SDCWA released a draft water purchase agreement with Poseidon for public review.” The same sentence is included in the paragraph that has been added at the top of page A-35, where it is less misleading.

**A-48 – Water Sales**
While we appreciate the addition of footnote 3 to disclose that 225,000 acre-feet of Metropolitan’s 1,676,855 acre-feet of water sales in 2012 were replenishment sales, the report of Metropolitan’s water sales remains misleading as a result of its use of “averages” and its inclusion of its transportation and exchange of the Water Authority’s Colorado River water as “water sales” by Metropolitan. Providing more detailed information about actual sales rather than “average” sales would help investors understand important and substantial trends in the volume of sales and price of Metropolitan water.

**A-52 – Member Agency Purchase Orders**
Metropolitan fails to disclose the conclusion reached by Metropolitan’s own staff and reported to the board of directors, that the use of Purchase Orders fails to meet the board’s articulated objective of providing for an annual assured revenue stream sufficient to pay Metropolitan’s costs. Metropolitan’s Purchase Orders are also subject to the requirements of state law and the state constitution including but not limited to Proposition 26.

**A-53 – Classes of Water Service (Replenishment)**
The description of the “Replenishment Service Program” as a sound water resource and financial program is inconsistent with Metropolitan’s own assessment of the Program as featuring “questionable and unquantifiable performance criteria for a discounted water program,” loss of full service sales due to the availability of discounted water and the unequal distribution of costs and benefits among the member agencies. Given that Metropolitan has disclosed that it remains in

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5 Although it will not solve the bigger problem associated with Metropolitan’s use of averaging, we suggest that you include the word “discounted” before “replenishment sales” in footnote 3.

6 See the Water Authority’s September 10, 2012 letter to the board RE Update on “Rate Refinement” (Board Information Item 7-b), available at www.MWDFacts.com.

7 See Metropolitan’s April 26, 2011 Board Memo 5-1 and a long series of letters on this subject included in the Discounted Replenishment Water section of www.MWDFacts.com.
discussion with its member agencies about how to continue discounted water sales under a new label (“incentive-based water storage program”), the last paragraph of this section, describing the fact that discounted water sales offset full service water sales, should not be deleted.

A-65 and A-70 – Variable Rate and Swap Obligations
Metropolitan has added a number of disclosures in its official statement regarding a possible loss in the value of its existing swap transactions that could be as high as $169 million if interest rates remain unchanged or do not increase substantially during the remaining life of the swap agreements which range between 8-12 years. Further, it appears that the counterparty holding the swap can elect to terminate during optional dates which would result in an immediate loss to Metropolitan. This should also be disclosed in Metropolitan’s offering statement. Please advise if this is a correct interpretation of the disclosures added to the offering statement and whether these investments are consistent with the board’s investment policy.

A-79 – Historical Projected Revenues and Expenditures
See discussion at A-48 and footnote 5 of this letter, that the word, “discounted” should be added before the words, “replenishment sales” in footnote (b) at page A-80.

In addition, given (1) Metropolitan’s actual water rate increases as described; (2) Metropolitan’s reduced water sales as described at section A-3 of this letter; (3) the time line within which Metropolitan is legally required to disclose and begin to manage payment of its combined unfunded retiree health care obligation and unfunded pension obligation currently totaling $757 million; and (4) the projected time line for BDCP implementation, there is no reasonable basis for the statement by MANAGEMENT that “rates and charges are projected to increase 3.0 percent per fiscal year” beginning in 2015 and thereafter. The actual rate increases over the past five years are a far better indicator of Metropolitan’s future rate increases than the projection by MANAGEMENT.

A-81 – Board direction to staff to evaluate cost-of-service methodology to ensure that all rates and charges recover the full cost of service effective January 1, 2011
It should be disclosed that the Water Authority’s MWD rate litigation alleges that Metropolitan has failed to properly allocate its costs proportionally among the member agencies that benefit. The staff has also failed to comply with this board direction by failing to include in its cost of service a credible plan to pay the cost of Metropolitan’s unfunded retiree health care obligation and unfunded pension obligation – currently totaling $757 million. Given that investors rely upon the willingness of the Metropolitan board to raise water rates sufficiently to cover its expenses, it should be clearly disclosed in the Official Statement that these costs are not covered by the water rates and charges recommended by staff and approved by the board of directors. 9

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8 Indeed, development of a program for the sale of discounted water has been stated by the member agency managers to be one of Metropolitan’s top three “priorities.” See slide 2 of August 24, 2012 MWD Member Agency Managers Meeting PowerPoint Presentation.

9 Jerry Sanders, the Mayor of the City of San Diego, recently wrote to Metropolitan expressing his concern about this unfunded liability and the fact that Metropolitan does not have a plan to
A-81 – “Unrestricted” Reserve Balances
We do not understand how reserve balances that are held as collateral can be described as “unrestricted.” Please explain.

Except as otherwise noted, the comments in this letter, including those that are incorporated by reference, address only those issues that are actually highlighted in the draft revisions distributed by Metropolitan to the board of directors dated October 24, 2012.

Sincerely,

Keith Lewinger
Director

Vincent Mudd
Director

Fern Steiner
Director

Doug Wilson
Director

cc: Jeff Kightlinger, MWD General Manager
San Diego County Water Authority Board Members and Member Agencies
October 8, 2012

Gary Breaux
Assistant General Manager/Chief Financial Officer
Metropolitan Water District of Southern California
P. O. Box 54153
Los Angeles, CA 90065-0153


Dear Mr. Breaux:

We have reviewed the edits you made to the attachment to your September 4, 2012 letter (Revised Appendix A), which you represented as responding to the comments we provided in our letter to you dated August 20, 2012 (San Diego Comment Letter) and “other comments.” We request to be provided with a copy of any other comments you received that you took into account in making the edits to the Revised Appendix A. If we do not receive any response from you, we will understand that no other comments were submitted and that the edits were made by Metropolitan management.

While some of the edits respond to our comments, others clearly do not; and, many of our comments were not addressed in the Revised Appendix A. We also note that many of the changes you made to the final Revised Appendix A could have been made prior to the draft being distributed to the board for review (i.e., were not based on new developments). We would have commented on these edits at that time had the opportunity been provided. The following are our additional comments on Revised Appendix A, including some important issues we request be brought back to the board for discussion. All references are to the page numbers as in the Revised Appendix A attachment to your September 4, 2012 letter.

A-12: We presume your deletion of reference to the “commitment” by Metropolitan and the Santa Clara Valley Water District to surpass the 2009 Delta Reform Act water savings targets by 700,000 acre-feet per year based on predicted future demands was made in response to the San Diego Comment Letter (page 3, A-11 – BDCP). Our request, however, was not to delete the comment, but only to make clear that the board of directors has not made any such “commitment,” as described. Since this representation has apparently been made as part of the BDCP process and widely circulated in the media, we would still ask that you provide information to the board of directors regarding the details of the proposal, i.e., what share of the 700,000 acre-feet of additional conservation MWD staff has indicated a

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

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willingness to implement and how that will be factored into Metropolitan's water resources plans and cost projections.

A-18: The edits you made to the section describing the *Sale of Water by the Imperial Irrigation District to San Diego County Water Authority* misrepresent the language of the QSA and Exchange Agreements. The edits appear to be calculated to be more consistent with MWD’s recently constructed interpretation of the Exchange Agreement to support its claim that the Water Authority is in default under the Exchange Agreement. It is noteworthy the very language which has been used in past Official Statements is only now being edited (and as noted, without any opportunity having been provided to the board of directors to review the language in advance of the changes being made). We specifically object to the following changes on the grounds that the edits are inconsistent with the QSA and Exchange Agreements:

- Deletion of “delivered to” and substitution of “that is conserved within”
- Deletion of “deemed” and substitution of “that has been”
- All edits to the sentence that formerly began as, “Metropolitan makes no payment” and now begins, “In consideration for the conserved water.”
- Deletion of the sentence at the bottom of page A-18 through the first two lines of page A-19.
- Addition of the first sentence to the first full paragraph of page A-19.
- Addition of the last three sentences of the first full paragraph of page A-19, except the language, “Metropolitan served SDCWA with a Notice of Default” and “has invoiced SDCWA for its higher water rate.”

In addition, the Revised Appendix A is misleading in that you failed to make any changes to describe the substantial risks to Metropolitan and its ratepayers if the QSA agreements are interrupted, specifically, reduced availability of Colorado River water supplies, reduced water supply reliability, increased chances of water shortages and likelihood of increased water rates for MWD ratepayers.

A-30: MWD should delete the words, “if any,” from the sentence that begins, “Future reliance on Metropolitan supplies.” Given all of the local projects already being developed and planned to be developed within the Metropolitan service territory, it is unreasonable to suggest the possibility that, in the future, no amount of water will be derived from sources other than Metropolitan.

A-31: Regarding the turnout agreement between the California Department of Water Resources, Antelope Valley-East Kern Water Agency (AVEK) and Metropolitan, we request a full board report on the edit made deleting the word “limits” and substituting the words “allows for.” This agreement was the subject of significant controversy at the time it was executed by then General Manager, Ron Gastelum, without the knowledge or approval of
the Metropolitan board of directors. One of the representations that was made was that the turnout would be *strictly limited*. Please explain why this edit was made. Also, please explain why you moved the following sentence from the Revised Appendix A from A-31 to A-30: “The City’s future reliance on Metropolitan supplies will be dependent on these projects and the amount of water, if any, that may be derived from sources other than Metropolitan.” The original disclosure following the LA-AVEK agreement is a more logical location than the revised.

Our concerns about these edits are exacerbated by your failure to correct a major deficiency in the Official Statement, namely, that it contains a great deal of information about the plans of the City of Los Angeles to buy less water from Metropolitan in the future, based on its Urban Water Management Plan, but does not disclose the same information for the Water Authority and other agencies who also have plans described in their Urban Water Management Plans to purchase less water from Metropolitan in the future. We again ask that you make all of the edits suggested in the San Diego Comment Letter *RE A-28 – Regional Water Sources* so that the Official Statement reports *all of Metropolitan’s member agency plans to develop local water supplies*. You may also wish to add a disclosure that Metropolitan has mounted a public affairs campaign in San Diego and elsewhere to try to convince local elected officials and water ratepayers to abandon these plans and instead rely upon Metropolitan’s imported water supplies which it alleges will be available to replace local supplies and can be obtained at a lower cost.

A-33 and A-52: The edits made regarding replenishment service are misleading in that they appear to be designed to suggest that MWD’s flawed business model of buying “high” and selling “low” has been addressed by elimination of replenishment service. As noted in the San Diego Comment Letter, Metropolitan has refused to disclose how much of its “demand” is only for discounted water (i.e., sales that will only occur at a discount). When one agency buys water at a discount, another agency has to pay for that discount. While it is accurate that no replenishment sales are budgeted (or included in Metropolitan’s cost of service) for Metropolitan’s fiscal years 2012-13 and 2013-14 budgets, Metropolitan and the member agencies have identified the continued sale of discounted water as a “priority” using new lingo (“incentive-based”) that has the same net effect to Metropolitan’s revenues and fiscal stability. The edits you made do not address the issues presented in the San Diego Comment letter. See San Diego Comment Letter, *A-50 – Replenishment*.

A-40: You did not make any of the edits requested to reflect the real reason why actual and projected pay-as-you-go funding has consistently been less than budgeted. Here again, your edits have made the Revised Appendix A more misleading, by changing the word “budgeted” to “projected.” Recent actual pay-as-you-go has consistently been less than *budgeted* and it is misleading to state otherwise.

A-50: You made edits changing the following sentence: “If Metropolitan’s rates are revised
in the manner proposed by SDCWA in the complaint, other member agencies would pay higher rates,” to, “If Metropolitan’s rates are revised in the manner proposed by SDCWA in the complaint, other member agencies may pay higher rates unless other actions are taken by the Board.” What is the reason for this change and what is the basis of the revised statement? Metropolitan and the member agencies have widely published in the litigation and elsewhere the premise that if the water rates were revised in the manner proposed by SDCWA, it would result in a commensurate increase in the water rates of other member agencies. If management has developed alternatives under which the member agencies would not pay more if the Water Authority litigation is successful, we request these be brought back to an upcoming Finance and Insurance Committee for review and discussion. Those alternatives should also be fully disclosed in Metropolitan’s Official Statement Appendix A.

A-72: The edit made to eliminate the reference to “water purchase estimates” associated with DWR’s annual billing for State Water Project Water are noted as self-serving and another late attempt to shore up Metropolitan’s own arguments in the SDCWA litigation.

With the exception of your response to A-4 – State Water Project and A-53 – Wheeling and Exchange Charges, and parts of A-18 – Sale of Water by the Imperial Irrigation District and A-50 – Interim Agricultural Water Program (IAWP), none of the concerns raised in the San Diego Comment Letter have been addressed by your edits to the Revised Appendix A.

Sincerely,

Keith Lewinger  
Director

Fern Steiner  
Director

Doug Wilson  
Director

cc: Jeff Kightlinger, MWD General Manager  
San Diego County Water Authority Board of Directors and Member Agencies
Impact of Restrictions on SWP Supplies

- 2008 = 494 TAF
- 2009 = 251 TAF
- 2010 = 770 TAF
- 2011 = 465 TAF
- 2012 = 535 TAF
- 2013 = 290 TAF and counting*

* A final accounting of losses can’t be made until the end of the year.
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<td>90,000</td>
<td>0</td>
<td>0</td>
<td>90,000</td>
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<td><strong>State Water Project System</strong></td>
<td>1,248,000</td>
<td>680,000</td>
<td>91,000</td>
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<td>MWD SWP Carryover</td>
<td>286,000</td>
<td>286,000</td>
<td>-16,000</td>
<td>270,000</td>
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<td>Castaic Lake (DWR Flex Storage)</td>
<td>154,000</td>
<td>154,000</td>
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<td>65,000</td>
<td>65,000</td>
<td>0</td>
<td>65,000</td>
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<td>Arvin Edison Storage Program</td>
<td>218,000</td>
<td>40,000</td>
<td>45,000</td>
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<td>Semitropic Storage Program</td>
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<td>56,000</td>
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<td>Kern Delta Storage Program</td>
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<td>Mojave Storage Program</td>
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<td><strong>In-Region Supplies and WSDM Actions</strong></td>
<td>887,000</td>
<td>594,000</td>
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<td>Diamond Valley Lake</td>
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<td>Foothill (Raymond and Monkhill)</td>
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<td>Compton</td>
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<td>Western</td>
<td>7,000</td>
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<td>Cyclic - Upper San Gabriel</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>40,000</td>
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<tr>
<td>Cyclic - Inland Empire Utilities Agency</td>
<td>0</td>
<td>0</td>
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<td><strong>Other Programs</strong></td>
<td>660,000</td>
<td>78,000</td>
<td>229,000</td>
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<td><strong>Total</strong></td>
<td>3,365,000</td>
<td>1,652,000</td>
<td>755,000</td>
<td>6,044,000</td>
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<td>Emergency</td>
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<tr>
<td><strong>Total WSDM Storage</strong></td>
<td>2,739,000</td>
<td>1,652,000</td>
<td>755,000</td>
<td>6,044,000</td>
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*Put and take capacity assumed under a 40% SWP Table A Allocation.

**Total WSDM Storage level is subject to change based on accounting adjustments.
Biennial Budget Regular Position Count
By Payroll Period

Positions

Authorized
Budgeted
Actual

Board Budget Workshop
December 27, 2012

Mr. Gary Breaux
Assistant General Manager/Chief Financial Officer
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90065-0153

Re: “Amended and Restated Purchase Order for System Water to be Provided by the Metropolitan Water District of Southern California” (“Revised Purchase Order Form”)

Dear Mr. Breaux:

The Water Authority’s board of directors has authorized the General Manager to sign the enclosed Revised Purchase Order Form (Attachment 1): 1) UNDER PROTEST; and, 2) with a full RESERVATION OF RIGHTS. The basis of our objection has been stated in past correspondence from the Water Authority to Metropolitan on a variety of subjects, including, but not limited to, the October 8, 2012 letter from the Water Authority’s Metropolitan board representatives to MWD Chairman Foley and Board Members (RE: Board Memo 8-3 — Approve the form of the amended and restated Purchase Order; and authorize amendment of section 4122 of the Administrative Code), a copy of which is Attachment 2 to this letter.

Background
At the outset, in response to your October 30 letter responding on behalf of Metropolitan’s Chairman of the Board to Attachment 2 (your October 30 letter is Attachment 3), we wish to note for the record that neither the staff presentation nor committee discussion (which was de minimis) responded substantively to the Water Authority’s comments and concerns in the manner you describe in your letter. If anything, the presentation confirmed exactly the point the Water Authority was making, namely, that the extension of the purchase order was not according to “existing terms and conditions,” but rather, contained several revisions. Copies of the presentation and a transcript of the committee “discussion” are Attachments 4 and 5, respectively.

Also, while we appreciate receiving your personal explanation of the board’s action on the Compton purchase order withdrawal, we must respectfully disagree with both your description of the board’s action as well as your interpretation of Metropolitan’s Administrative Code Section 4404 (b). Contrary to the suggestion in your letter, Board Memorandum 8-3 (Consider City of Compton’s request to withdraw purchase order
agreement) dated November 8, 2011 did not describe any general policy or “conditions” under which member agencies would be allowed to terminate purchase orders. It did, however, state expressly that, “If other member agencies request to withdraw their Purchase Order commitment, the same conditions for Tier 1 and Tier 2 payments and the administrative withdrawal fee would apply.” That statement is fully consistent with Section 4404 (b)’s requirement that all purchase orders shall be on “substantially the same terms and for the same term.” The characterization in your letter turns Section 4404 (b) on its head by suggesting that the board has discretion to treat individual member agencies differently under “contracts,” as opposed to broadly applicable board policy.

The reasons for our concern are obvious: we are already in litigation over Metropolitan’s use of contracts to discriminate against the Water Authority and its ratepayers. The Water Authority has also disputed Metropolitan’s characterization of “System Water” because it is an artifice designed by Metropolitan in an attempt to immunize itself from statutory and constitutional requirements to charge its member agencies no more than the actual, reasonable and proportional cost of the services it provides.

Through litigation discovery and documents obtained through Public Records Act Requests, the Water Authority is now aware of the plans by Metropolitan and some of its member agencies to play “gotcha” with the Water Authority through the use of phony contracts that the board may choose to enforce – or not – selectively.

Additional Comments
1. Execution of the purchase orders at this time is the ultimate act of form over substance, since 20 of the 23 member agencies with existing purchase orders, including the Water Authority, have already purchased more water than they are “committing” to buy in the Revised Purchase Order.

2. The purchase order is an illusory contract with no real consideration exchanging hands: Metropolitan has no duty to deliver water and the member agencies make no real commitment to pay the significant costs Metropolitan incurs to pay for its water supply, facilities and other programs.

3. There is no evidence to support the purchase order’s recital that Metropolitan is relying on the purchase orders in setting its rates and charges, in planning and providing capital facilities or in developing water supply, management and reliability programs. Indeed, there is a complete disconnect between these processes and the purchase orders.

4. We have disputed in court the purchase order’s recital that the purchase order is “entered into for the direct benefit of the holders and owners of Metropolitan’s bonds.” Inclusion of this language is merely a litigation ploy by which Metropolitan is attempting to immunize its water rates from legal challenge.
5. Contrary to the recitals, the purchase orders are not the product of negotiation and do not represent terms and conditions that are “mutually agreed by the parties.” Metropolitan’s member agencies have no alternative but to pay the water rates and charges imposed by Metropolitan for the services it provides, including rates and charges for the use of transportation facilities over which Metropolitan has monopoly control.

6. The Water Authority disputes that the Metropolitan board has complete discretion based on a majority vote to cut special deals with some agencies to the detriment of others. Metropolitan may not, through the use of “contracts,” immunize itself from statutory and constitutional requirements that it charge only the actual, reasonable and proportional cost of the services it provides.

Finally, I am attaching and incorporate by reference a copy of the Water Authority’s November 21, 2012 board memorandum on Metropolitan’s purchase order history (Attachment 6). This memorandum discusses Metropolitan’s complete failure over more than the past five years to develop a long term finance plan to pay for Metropolitan programs. The memorandum also discusses how the use of purchase orders has – by your own admission – failed to achieve the intended objective of providing Metropolitan an increased share of firm revenues to better match its fixed costs.

In summary, the Water Authority board has authorized the General Manager to execute the Revised Purchase Order Form: 1) UNDER PROTEST; and, 2) with a full RESERVATION OF RIGHTS, as stated above.

Sincerely,

[Signature]

Daniel S. Hentschke
General Counsel

cc: Metropolitan Water District Board of Directors
    San Diego County Water Authority Board of Directors

Attachment 1: Revised Purchase Order Form
Attachment 2: Water Authority’s MWD Delegates Letter, dated October 8, 2012
Attachment 3: MWD’s response, dated October 30, 2012
Attachment 4: MWD’s October 8 Presentation on Purchase Order extension
Attachment 5: MWD’s October 8 Purchase Order discussion transcript
Attachment 6: Water Authority’s Board Memo on MWD Purchase Order History, dated November 21, 2012
AMENDED AND RESTATED
PURCHASE ORDER FOR SYSTEM WATER TO BE PROVIDED BY
THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

<table>
<thead>
<tr>
<th>PURCHASER:</th>
<th>TERM</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAN DIEGO COUNTY WATER AUTHORITY</td>
<td>12 years</td>
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<table>
<thead>
<tr>
<th>INITIAL BASE FIRM DEMAND:</th>
<th>EFFECTIVE DATE:</th>
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<tbody>
<tr>
<td>557,095.1 acre-feet</td>
<td>January 1, 2003</td>
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<table>
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<th>INITIAL TIER I ANNUAL MAXIMUM:</th>
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<tbody>
<tr>
<td>501,385.6 acre-feet</td>
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<table>
<thead>
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<th>PURCHASE ORDER COMMITMENT:</th>
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</thead>
<tbody>
<tr>
<td>4,011,085.0 acre-feet</td>
<td></td>
</tr>
</tbody>
</table>

Definitions of capitalized terms used in this Purchase Order are provided in Attachment 1. Terms used in this Purchase Order and not defined in Attachment 1 are defined in Metropolitan’s Administrative Code.

COMMITMENT TO PURCHASE.

In consideration of Purchaser's commitment to purchase System Water pursuant to this Purchase Order, Metropolitan agrees to sell such System Water to Purchaser at the Tier 1 Supply Rate each year in an amount up to the Tier 1 Annual Maximum. System Water sold to Purchaser (excluding deliveries of interruptible water, including but not limited to the Interim Agricultural Water Program, Long-Term Seasonal Storage Service and Replenishment Service) in an amount greater than the Tier 1 Annual Maximum shall be sold to the Purchaser at the Tier 2 Supply Rate. In connection with the receipt of System Water, the Purchaser also agrees to pay all other applicable rates and charges, as established by Metropolitan from time to time in accordance with Section 4304 of the Administrative Code. The rates and charges applicable to System Water as of the Effective Date are shown in Attachment 2.

Purchaser agrees to purchase System Water from Metropolitan during the Term in an amount (excluding deliveries of interruptible water, including but not limited to the Interim Agricultural Water Program, Long-Term Seasonal Storage Service and Replenishment Service) not less than the Purchase Order Commitment.

Purchaser recognizes and agrees that Metropolitan has relied and will, during the term of this Purchase Order, rely on this commitment by Purchaser in setting its rates and charges, planning and providing its capital facilities and developing its water supply, management and reliability programs. If Purchaser's applicable System Water purchases during the Term are less than the Purchase Order Commitment, Purchaser agrees to pay Metropolitan an amount equal to the difference between the Purchase Order Commitment and Purchaser's applicable System Water purchases during the Term times the average of the Tier 1 Supply Rate in effect during the Term. The Purchaser agrees to pay such amount to Metropolitan within the next regular billing cycle following the reconciliation of all certifications for special programs that the Purchaser may participate in (e.g. Interim Agricultural Water Program, Long-term Seasonal Storage Service). The Purchaser may elect to pay such amount in twelve equal monthly payments over the course of the next twelve months beginning with the first regular billing cycle.
following the reconciliation of all outstanding certifications for special programs. If the Purchaser elects to pay such amount over the course of the next twelve months following the regular billing cycle any outstanding balance shall bear interest at Metropolitan's then current investment portfolio average yield. All other amounts payable under this Purchase Order shall be billed and paid in accordance with the Administrative Code.

The Purchaser further recognizes that this Purchase Order is entered into for the direct benefit of the holders and owners of Metropolitan's Bonds issued from time to time under the Act and the Bond Resolutions, and the income and revenues derived from this Purchase Order will be pledged for the purposes set forth in the Bond Resolutions, including the payment of principal of and interest on such Bonds.

RENEWAL:
Prior to but not later than December 31, 2010, the Purchaser may provide a non-binding written notice to Metropolitan of the Purchaser's determination to extend this Purchase Order. Upon the receipt of such notice, the Board of Directors of Metropolitan (the "Board") shall determine whether Metropolitan will continue to provide System Water to member agencies by Purchase Order. If the Board so determines, the Purchaser and Metropolitan shall amend this Purchase Order to include an extended term and/or to include such other terms and conditions as may be mutually agreed by the parties. If the Purchaser elects not to renew this Purchase Order it will terminate upon the expiration of the Term.

WATER SERVICE:
Conditions of water service by Metropolitan to the Purchaser, including but not limited to (i) delivery points, (ii) water delivery schedules, and (iii) water quality, will be determined in accordance with Chapter 5 (Section 4500 through 4514, inclusive, as applicable) of Metropolitan's Administrative Code.

In accordance with its Administrative Code, Metropolitan shall use its reasonable best efforts to supply System Water in the quantities requested by the Purchaser, but is not obligated to dedicate any portion of System capacity for the conveyance, distribution, storage or treatment of System Water for the benefit of the Purchaser or any other member agency. Metropolitan shall use its reasonable best efforts to deliver the Firm Demand when needed by the Purchaser during the Term; provided however, there shall be no default under this Purchase Order if Metropolitan fails to deliver water to the Purchaser in accordance with any such schedule of deliveries during the Term.

By execution of this Purchase Order, the Purchaser recognizes and agrees that it acquires no interest in or to any portion of the System or any other Metropolitan facilities, or any right to receive water delivered through the System, excepting the right to purchase up to Purchaser's Tier 1 Annual Maximum at the Tier 1 Supply Rate provided that System Water is available. This Purchase Order governs pricing of the System Water delivered to the Purchaser pursuant to this Purchase Order and does not confer any entitlement to receive System Water.

System Water provided to the Purchaser under the terms of this Purchase Order shall be subject to reduction in accordance with the shortage allocation provisions of the Water Surplus and Drought Management Plan (the "WSDM Plan") or other such policies and principles governing the allocation of System Water as adopted by the Board.

In the event that Metropolitan's Board determines to reduce, interrupt or suspend deliveries of System Water, any outstanding balance of the Purchase Order Commitment at the end of the Term shall be reduced by the reduction in System Water made available to the Purchaser under this Purchase Order.
MISCELLANEOUS:
This Purchase Order will be interpreted, governed and enforced in accordance with the
laws of the State of California.
This Purchase Order will apply to and bind the successors and assigns of the Purchaser and Metropolitan.
No assignment or transfer of the rights of the Purchaser under this Purchase Order will be valid and effective against Metropolitan or the Purchaser without the prior written consent of Metropolitan and the Purchaser.
If at any time during the Term, by reason of error in computation or other causes, there is an overpayment or underpayment to Metropolitan by the Purchaser of the charges provided for under this Purchase Order, which overpayment or underpayment is not accounted for and corrected in the annual re-determination or reconciliation of said charges, the amount of such overpayment or underpayment shall be credited or debited, as the case may be, to the Purchaser. Metropolitan will notify the Purchaser in writing regarding the amount of such credit or debit, as the case may be. In no case will credits or debits for charges provided for under this Purchase Order be administered beyond the limit for billing adjustments as specified in Metropolitan’s Administrative Code.

IN WITNESS WHEREOF, this Amended and Restated Purchase Order is executed by the duly authorized officers of the Metropolitan Water District of Southern California and San Diego County Water Authority, as of December 27, 2012.

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

By: ____________________________
    Jeffrey Kightlinger
    General Manager

SAN DIEGO COUNTY WATER AUTHORITY

By: ____________________________
    [Title]  General Manager

APPROVED AS TO FORM AND CONTENT:

______________________________  ______________________________
General Counsel                      General Counsel

By: ____________________________  By: ____________________________
Attachment 1
Amended and Restated Purchase Order for System Water

DEFINITIONS

"Act" means the Metropolitan Water District Act, California Statutes 1969, Chapter 209, as amended and supplemented from time to time.

"Base Firm Demand" means the greater of (i) the Initial Base Firm Demand Post IAWP or (ii) the ten-year rolling average of the Purchaser's Firm Demand, measured on a fiscal year basis.

"Bonds" means water revenue bonds or notes issued under the Bond Resolutions.

"Bond Resolutions" means Resolution No. 8329 or Resolution No. 8322, both as amended and supplemented, or any other resolution authorizing the issuance of bonds, notes or other obligations secured by Metropolitan's water sales revenues.

"Effective Date" means the effective date of this Purchase Order as specified above.

"Firm Demand" means the Purchaser's purchases of non-interruptible System Water supplies, including full service, seasonal shift, Conjunctive Use Program, Surface Storage Operating Agreement water, Recharge and Recovery Operating Agreement water, or any other water program deemed to be a firm delivery of water.

"Initial Base Firm Demand" means the Purchaser's highest annual Firm Demand on Metropolitan in any fiscal year during the period from fiscal year 1989/90 through fiscal year 2001/02. In accordance with procedures set forth in Metropolitan's Administrative Code, the Initial Base Firm Demand will be revised to reflect certified and verified deliveries under the Interim Agricultural Water Program and Long-term Seasonal Storage Service Program as such certifications affect the Initial Base Firm Demand.

"Initial Base Firm Demand Post IAWP" means the Purchaser's highest annual delivery of water from the District, excluding water delivered under Long-Term Seasonal Storage Service and other deliveries of interruptible water but including Interim Agricultural Water Program deliveries, during any fiscal year from fiscal year 1989/90 through fiscal year 2001/02.

"Metropolitan" means The Metropolitan Water District of Southern California.

"Purchase Order Commitment" means 60% of the Initial Base Firm Demand times 12. Deliveries of System Water made under the Interim Agricultural Water Program and Long-Term Seasonal Storage Service will not count toward the Purchase Order Commitment.

"Purchase Order" means this Amended and Restated Purchase Order for System Water.

"Purchaser" means the member public agency specified above, a duly organized [city/water district/county water authority] of the State of California.

"System" means the properties, works and facilities of Metropolitan necessary for the supply, development, storage, conveyance, distribution, treatment or sale of water.
“System Water” means water supplies developed by Metropolitan and delivered to the Purchaser through the System or other means (e.g. conjunctive use storage).

“Term” means the term of this Purchase Order as specified above.

“Tier 1 Annual Maximum” means an amount equal to 90% of the Base Firm Demand.

“Tier 1 Supply Rate” means Metropolitan’s per-acre-foot Tier 1 Supply Rate, as determined from time to time by Metropolitan’s Board of Directors. The initial Tier 1 Rate is $73/AF.

“Tier 2 Supply Rate” means Metropolitan’s per-acre-foot Tier 2 Supply Rate, as determined from time to time by Metropolitan’s Board of Directors. The initial Tier 2 Rate is $154/AF.

“Water Surplus and Drought Management Plan (WSDM)” means Metropolitan’s policy and procedures for managing supplies and drought conditions as adopted by the Board from time to time.
# Attachment 2
## Amended and Restated Purchase Order for System Water
### RATES AND CHARGES

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October 8, 2012

Jack Foley, Chair of Board
and Members of the Board
Metropolitan Water District
P. O. Box 54153
Los Angeles, CA 90065-0153

RE: Board Memo 8-3 – Approve the form of the amended and restated Purchase Order; and authorize amendment of section 4122 of the Administrative Code

Dear Mr. Foley and Board Members,

We have reviewed Board Memo 8-3 including Attachments. We are prepared to recommend to the Water Authority board of directors renewal of the purchase order commitment for two years, to December 31, 2014, “under the existing terms and conditions,” in accordance with the recommendation stated in the “Executive Summary” at page one, paragraph one of the board memo and as reflected in Attachment 3, Page 1 of 1, 2013, Tier 1 Limit and 2003 – 2014 Purchase Order Commitment. However, we are unable to recommend execution of the new form of Purchase Order which contains unexplained changes to the existing terms and conditions.

The “Details” section at page one, paragraph two of the board memo states that the new form of agreement contains amendments to definitions “to align the Purchase Orders with water programs implemented since the 2002 execution of the Purchase Order.” However, there is no explanation provided of the “alignment.” In fact, none of the definitional changes are necessary in order to achieve the stated objective of extending the purchase order for an additional two years under the existing terms and conditions or to “align” the Purchase Order to “new water programs.” The extension of the purchase order commitment could be accomplished simply by amending Section 4122 and the Purchase Order to reflect a “twelve-year” instead of a “ten-year” rolling average of deliveries of water (subject to adding one additional board policy change noted below).

Instead of presenting this simple amendment, however, an “amendment and restatement” of the Purchase Order is proposed. A contract amendment does not replace the whole original contract (just the part that’s changed by the amendment, here, a simple change from ten-years to twelve-years). Only when a contract requires extensive changes is it the common practice to create an entirely new agreement in the form of an “amendment and restatement.”

For example, a number of terms that are not defined in Metropolitan’s Administrative Code or included in its cost of service analysis are used in the new form of Purchase Order (e.g., “non-interruptible System Water supplies,” and “Recharge and Recovery Operating Agreement...
water,” among others). The edits to the definitions are unnecessary and whatever the intent, the proposed amendments are inconsistent with the explanation being provided by staff that the Purchase Orders are being extended under the “existing terms and conditions.”

Finally, while staff has included a number of unexplained changes to the form of the Purchase Order, it has left out the only policy change that has actually been adopted by the board of directors. That is that any member agency may withdraw and terminate its Purchase Order commitment upon the payment of a $5,000 administrative withdrawal fee. See November 8, 2011 Board Memorandum 8-3, adopted by the board on the same date. This provision should be included in the amended Purchase Order commitment.

In closing, we reiterate the concerns expressed in our September 10, 2012 letter to you RE Update on Rate Refinement (Board Information Item 7-b) (copy attached) including the inefficacy of Metropolitan’s Purchase Orders to achieve the objective of securing a revenue stream sufficient to pay Metropolitan’s costs, or, to provide a reasonable basis for the planning and provision of long term capital facilities and water supply programs. Metropolitan’s staff has acknowledged that Purchase Orders do not achieve these objectives, and yet, these critical financial decisions are being deferred for another two years. We are troubled by the continued spending patterns and practices at Metropolitan which do not provide sufficient fixed revenues at the same time the member agencies and board members are unable to agree how these fixed costs will be paid for over the long term. The trend and signals that we see are that Metropolitan’s member agencies intend to purchase less, not more water from Metropolitan. The continued spending could result in substantial stranded costs as well as massive rate hikes that would be necessary to pay for these programs with a declining sales base.

We assume other agencies will be required to obtain the approval of their governing boards. Our recommendations to the Water Authority’s board of directors will be as described in this letter.

Sincerely,

Keith Lewinger  Fern Steiner  Doug Wilson
Director    Director    Director

Attachment

cc: San Diego County Water Authority Board of Directors
September 10, 2012

John V. Foley, Chairman
and Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

RE: Update on “Rate Refinement” (Board Information Item 7-b)

Dear Mr. Foley and Members of the Board:

The board will be receiving yet another abbreviated, non-substantive report on “Rate Refinement” at this month’s board meeting. This month, staff is recommending a two-year extension of the Purchase Orders in spite of the fact that, less than two months ago, staff had concluded and reported to the board that the use of Purchase Orders failed to meet the board’s articulated objective of providing for an annual assured revenue stream sufficient to pay Metropolitan’s costs.

Staff recommendation, apparently driven by the continued unwillingness of the member agency managers to make any financial commitments to pay Metropolitan costs, is to once again “punt” any further board deliberation or discussion until 2013. This month’s power point presentation – the only information being provided to the board of directors – says that there just isn’t enough time to evaluate the most recent new idea to pay for Metropolitan projects, even though the discussions have been underway since mid-2007. Extension of the Purchase Orders creates the appearance of an interim solution but is in substance, nonsensical.

“Shifting” discussions about discounted water sales to the Water Planning and Stewardship Committee will not change the fact that there are important fiscal implications from the sale of discounted water that must be, but are not presently accounted for in Metropolitan’s cost of service. Indeed, no replenishment service was included in the biennial budget or taken into account in setting water rates and charges adopted by the board for the 2013 and 2014 fiscal years. Changing the label on or process to secure discounted water will not change the fact that there are cost of service and water rate implications that are required to be addressed by the board as part of its rate-setting process.

Finally, “Rate Refinement” is an artifice. This lingo, as well as other “housekeeping” and Administrative Code changes have all been designed to perpetuate the myth that Metropolitan’s “rate structure” has remained unchanged. In the final analysis, the facts will
speak for themselves and there will be no question but that there have been and continue to
be implemented by Metropolitan, board actions that affect how Metropolitan’s costs are
being paid without regard to who benefits.

Attached is a copy of our July 9, 2012 letter regarding Update on Rate Refinement
Discussions, along with Director Wilson’s August 16, 2012 letter to the Chief Financial
Officer, which we incorporate by reference. While we were surprised by the CFO’s recent
letter advising Director Wilson that all of these issues had been presented by the
professional staff and discussed by the board, we will review our notes to see if there are
board memoranda we have overlooked or meetings we have failed to attend and will be
back in touch with you on that point.

Sincerely,

Lynne Heidel
Director

Keith Lewinger
Director

Fern Steiner
Director

Doug Wilson
Director

Attachment 1: Letter regarding Rate Refinement, July 9, 2012
Attachment 2: Letter from Director Wilson to Chief Financial Officer, August 16, 2012
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
Director

Keith Lewinger
Director

Fern Steiner
Director

Doug Wilson
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
August 16, 2012

Gary Breaux  
Chief Financial Officer  
Metropolitan Water District of Southern California  
P.O. Box 54153  
Los Angeles, CA 90054-0153

Re: Rate Refinement Workshop

Dear Gary,

I wanted to give you some of my thoughts on the issues the rate refinement board workshop should include on MWD’s finance plan and water rates. The “big picture” was described in the July 9, 2012 letter the San Diego board members sent to Chairman Foley requesting the workshop. That letter included concern for MWD financial stability given the high fixed costs versus low fixed revenues and questions how MWD will ensure sufficient revenues to pay its future costs and avoid stranded investments. Chairman Foley indicated that a workshop would be held. To assist in your preparation for the workshop, I went back through some of the other letters we have written to MWD on issues of concern and I thought it might help you to provide a short list of some of the key questions.

1. How can MWD execute a long term contract for the BDCP unless it has an assured source of revenue to make the payments?
2. Are ad valorem tax increases on a regular basis a real possibility? If so, what steps need to be taken to advance that approach? And, could this be the realistic solution to fund the BDCP?
3. Will the member agencies agree to sign take-or-pay contracts? If not, isn’t MWD being asked to carry all of the risk of stranding the BDCP and other investments? Is that a reasonable risk for our board to agree to assume?
4. What will happen if MWD’s sales continue to decline at the same time we continue to embark on new projects? How will MWD’s liabilities be paid? What legal mechanism exists to recover stranded costs? Will MWD be required to sign so-called “step up” agreements on the remaining ratepayers could have to cover if the other State Water Contractors default?
5. Are peaking costs being adequately charged and collected under the current rate structure? With so many MWD costs being incurred to meet dry-year peaking demands (not just for treated water), what mechanisms can MWD put in place in order to send the right price signal to ensure that agencies generating peaking costs are in fact paying those costs? Our calculations show that the current capacity and RTS charges do not fully recover these peaking costs.
6. In light of reduced sales projections, does it make sense for MWD to continue to pay its member agencies to NOT buy MWD water?
7. Given that the 20% by 2020 requirement is a retail requirement, and that MWD sales are down by more than 30%, does it make sense for MWD to continue to make current investments in water conservation? Or, should it defer those investments until sales begin to improve? Why hasn’t our adaptive IRP adapted to reduced sales?

8. If MWD is going to make additional investments in water conservation, shouldn’t it reduce the amount of money it is spending on other water supplies by a like amount?

9. How will MWD ensure that its revenues are in fact sufficient to meet its operating expenses over the next five years? At my local agency at Padre Dam, we call this “living within the household budget”. That is to say that expense is reduced to match the long term revenue stream, not the reverse.

10. What are the risks associated with projecting water sales based on “average” pricing? Will groundwater agencies buy as much water from MWD if it isn’t discounted? Will other agencies pay more in order to subsidize discounted water sales especially as agencies develop new local supplies reducing their dependence on Met?

11. Given all of the changed circumstances, including the increasing cost of MWD water, is it reasonable to rely on historical data in projecting future water sales?

There are other issues and questions but this is a pretty good list of the issues I see that the Water Authority has raised over the past couple of years. We look forward to working with you and our fellow board members to ensure MWD’s future and long term fiscal sustainability.

Sincerely,

Doug Wilson
Director

Attachments (without original enclosures):
1. July 9, 2012 re: Update on Rate Refinement Discussions
2. July 22, 2012 re: Board item 8-3 (LRP)
3. May 7, 2012 re: Board item 8-4 (conservation program)
4. March 21, 2012 re: Recommendation to cap MWD rate increases at 3%
5. March 12, 2012 re: LRP's
6. February 13, 2012 re: Board item 8-2 (draft remarketing statement)
7. February 3, 2012 re: Biennial budget
8. December 13, 2011 re: SB60
9. November 4, 2011 re: Board item 8-8 (discounted replenishment program)
10. October 25, 2011 re: KPMG audit report
11. October 7, 2011 re: WP&S items
13. August 16, 2011 re: Member agency willingness to sign take-or-pay contracts
14. May 6, 2011 re: Board item 5-2 (sale of discounted water)
15. December 9, 2010 re: Draft official statement
16. September 22, 2010 re Draft official statement
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 11, 2012

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

Re: Board Item 8-3 -OPPOSE

Authorize entering into a Local Resources Program agreement with Municipal Water District of Orange County and the city of San Clemente for the San Clemente Recycled Water System Expansion Project. (WP&S)

Mr. Foley and Members of the Board,

The Water Authority OPPOSES Board Item 8-3 on the following grounds:

Under California law including Proposition 26, MWD is required to set water rates that do not exceed the reasonable costs of providing the particular service for which the rate is charged, and that are equitable, fair and non-discriminatory. MWD has failed to present in Board Memo 8-3, by reference to its outdated Integrated Resources Plan (IRP), even more outdated 2007 LRP “target” or otherwise, any showing that MWD’s payments for this local water supply project will benefit any ratepayers other than those of the city of San Clemente, which will own the water supply. There is no demonstration that any water supply or transportation costs are avoided by MWD as a result of these payments. The bald assertion in Board Memo 8-3 that, “the project would strengthen regional water supply reliability” is insufficient to meet the requirements of California law.

Far from benefitting ratepayers of other member agencies, MWD’s continued payment of these subsidies under current circumstances harms all other MWD water ratepayers by further reducing demand for MWD water, thereby reducing MWD’s own revenues and driving up the cost of its water purchased by customers of other MWD member agencies. Moreover, MWD staff’s continued recommendations to approve subsidy agreements is inconsistent with its own actions months ago to suspend its “Local Resource Development Strategy Task Force” in order to reexamine the merits of the program and the water demand projections upon which it is based.

MWD’s expenditures have exceeded its revenues in three out of the past four years because water sales are down by more than 30% since the 2010 IRP was adopted, let alone the 2007 LRP “target” for local resources development. Rather than respond to these changed circumstances (consistent with the IRP’s articulated “adaptive management”), MWD is consciously choosing to rely on outdated water supply and financial planning that assume bloated water demands that do not exist and are not reasonably projected to exist in the foreseeable future.

A public agency providing a safe and reliable water supply to the San Diego region
In addition to these grounds, the Water Authority objects to being charged a “Water Stewardship Rate” (WSR) to pay for this project because its ratepayers have been barred by the MWD board’s August 2010 action from receiving any WSR benefits. Accordingly, the WSR is discriminatory, violates California law and may not be collected from the Water Authority’s customers.

As part of the lawsuit it has filed challenging MWD’s 2013 and 2014 water rates, the Water Authority is seeking to be relieved of any financial responsibility for this and other WSR projects approved by the MWD board of directors, so that the agencies that do not object may pay for these projects. As stated previously, the Water Authority has no objection if other MWD member agencies want to “pool” their money, however, that activity must be voluntary and not part of the water rates imposed by MWD on the ratepayers of all of its member agencies.

Sincerely,

Lynne Heidel
Director

Keith Lewinger
Director

Fern Steiner
Director

Doug Wilson
Director

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

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1 Attachment 3 to Board Memo 8-3 states in a footnote that, “IRP studies show reduced long-term costs to the region when local resources are developed due to downsizing or deferral of Metropolitan’s capital improvements, reduction in operating costs for importation, treatment and distribution, and reduction in costs for developing alternative regional supplies. These benefits are realized by all Metropolitan member agencies through improved regional water supply reliability.” However, there is no evidence to support this broad claim, which is insufficient in any case to meet the requirements of California law including but not limited to Proposition 26.

II See February 14, 2012 Board Letter 8-2, page 60, note 5.
May 7, 2012

John V. Foley, Chairman
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 8-4 – OPPOSE
Authorize changes to water conservation incentives (subsidies) as described

Dear Mr. Foley:

The Water Authority and its member agencies have a long and proud record of leadership in water conservation planning and implementation, based on strategic initiatives that will continue to reduce the region’s reliance on imported water supplies at an affordable cost. Given MWD’s role as a supplemental wholesale water provider – and taking into account the state mandate for 20% water conservation by 2020 at the retail level – the San Diego delegation does not support Agenda Item 8-4, to provide additional “incentives” to encourage water conservation. We have written to you and the board many times on this subject (reference to past correspondence is included below but not attached), so we provide only the following brief summary of the basis of our analysis.

*Due to reduced demand for MWD water – and associated higher water rates – there is no need for MWD to pay subsidies to encourage water conservation at the wholesale level.*

Water sales are already down at MWD by more than 30%. When sales are reduced, water rates go up as ratepayers are forced to pay more for using less water. As outlined in our March 21 letter to you and the rest of the board, it is time to stop punishing water use efficiency efforts by Southern California ratepayers who are already paying for water use efficiency programs at the retail level to meet the 20x2020 mandate.

*The Water Stewardship Rate which is collected to pay for MWD conservation subsidies violates California law.* The Water Stewardship Rate does not fairly apportion or reflect the actual, reasonable and proportionate costs of the services for which the rate is imposed. The Water Stewardship Rate violates the legal requirements of MWD’s principal act, Proposition 13 and the statutes implementing it, Government Code § 54999.7, the California common law of utility rate-making and Proposition 26. The Water Authority has provided MWD with detailed analyses by expert consultants establishing that the Water Stewardship Rate is legally defective.

A public agency providing a safe and reliable water supply to the San Diego region
The so-called “Rate Structure Integrity” clause adopted and imposed on the Water Authority by the MWD board of directors precludes any possible benefit to San Diego ratepayers from many MWD conservation programs. The board memorandum does not disclose that San Diego ratepayers are precluded from participating in MWD subsidy programs to the same extent as other MWD member agencies. We request that you include information in future board memoranda to fully disclose that information.

From a water resource planning, budget and policy point of view, we strongly encourage MWD to develop and implement a water conservation program that is better suited to its role as a wholesale water provider, that is based upon a calculable demonstration of need and avoided water supply cost (e.g., reduced take from the Delta, elimination of subsidies for member agency seawater desalination, etc.). Unfortunately, rather than viewing water use efficiency as a key part of its water resource plan and cost containment strategy – as recommended by the Water Authority for many years and by NRDC in its April 6, 2012 letter to you – MWD continues to limit itself to subsidy programs that are more appropriate at the retail level where the statewide conservation mandate has been imposed.

Sincerely,

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

cc: Ed Osann, NRDC Senior Policy Analyst

Past correspondence to MWD RE water conservation programs and subsidies:
- August 16, 2010 letter on MWD staff analysis on opt-in/opt-out conservation program
- November 29, 2010 comments on MWD draft Long Term Conservation Plan (LTCP)
- July 20, 2011 comments on LTCP working draft Version 11
- August 15, 2011 letter opposing LTCP and revised policy principles
- November 13, 2011 letter RE turf replacement grant
March 21, 2012

John V. Foley, Chairman
and Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

Re: Recommendation to Cap MWD Rate Increases at 3% for 2013 and 2014

Dear Mr. Foley and Members of the Board,

We were disappointed that the majority of the MWD board of directors did not feel that it would be productive to meet together as a board to discuss approaches to lowering MWD’s proposed rate increases for 2013 and 2014, in advance of our board vote in April. As a result, we are submitting this letter to you and all members of the board for consideration prior to the April 10 board meeting.

RECOMMENDATION

We recommend that the board cap MWD “average” rate increases\(^1\) at 3% for 2013 and 2014. We believe this can be accomplished – without any reduction of capital spending to maintain the Colorado River Aqueduct or any other MWD infrastructure – by reducing MWD’s Operations and Maintenance (O&M) expenditures by 10% and suspending conservation funding for the next two years. These changes would reduce the proposed two-year budget by $116.5 million and allow the “average” rate increases to be capped at 3% or less in 2013 and 2014.\(^2\)

Our recommendation would also direct staff to return to the board with specific budget reductions to accomplish the minimum 10% reduction in O&M (or, $76.5 million in expenditures over the two years – without changing the scheduled OPEB funding).

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\(^1\) No one pays an “average” water rate at MWD – for example, MWD’s proposed Tier 1 Treated water rate increase for 2013 is 9.3%, and its Tier 1 Untreated water rate increase is 8.6%.

\(^2\) Staff indicated previously that in order to reduce the rate increase from 7.5% for 2013 and 5% for 2014, to 5% for both years, it would need to cut expenditures by $26.4 million over the two year period. Based on this formula, we assume that cutting expenditures by $116.5 million (more than 4 times $26.4 million) would allow the rate increases for both years to be held to 3% or less. If this assumption is incorrect, then we ask that MWD staff provide the board with the amount of the budget reduction necessary to hold rates to 3% or less over the next two years.
BACKGROUND

In its budget and recommended “average” proposed water rate increases of 7.5% and 5% for 2013 and 2014, respectively, MWD staff proposed to increase the O&M budget by $15 million in 2013 and $22.5 million in 2014, including higher travel expenses, staffing levels and consulting services. This budget proposal increases MWD’s O&M budget by $52.5 million over the two years, and includes staffing increases of at least 42 or as many as 80 new employees.\(^3\)

In response to board member requests to lower the first year “average” rate increase to 5%, staff recommended a mix of reduced expenditures ($14 million and $13 million, respectively for 2013 and 2014), reducing Central Valley storage funding and $5 million per year reduction of conservation funding or other cuts of similar magnitude.

Staff’s recommended budget is inconsistent with MWD water sales and revenue trends, discussed below. It is also out of step with cities and other public water suppliers throughout Southern California that have been forced to make the difficult decisions to reduce expenditures as a result of declining revenues. Rate increases to support expanded budgets, including more staff and increased spending, ignore the economic realities our water ratepayers are facing. Budget reductions should target reduced spending rather than water supply programs such as the Central Valley storage funding.

DISCUSSION AND OTHER CONSIDERATIONS

Protection of Colorado River Aqueduct and Other Infrastructure – We agree it is important to maintain MWD infrastructure investments, including the Colorado River Aqueduct. That’s why our proposal would leave intact all capital spending as proposed by staff. But as we all know, repair and replacement of aging infrastructure is not the “No. 1 driver” of MWD’s proposed water rate increases.

Stop Punishing Water Conservation by Southern California Ratepayers – Water ratepayers across the Southland have responded to our call to reduce water usage over the past few years. Now, water ratepayers do not understand – and they are angry – that they are being asked to pay more for using less water.\(^4\) In fact, reduced demand for MWD water is the principal reason MWD’s rates have risen 75% since 2006, and the principal reason why MWD’s expenditures have

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\(^3\) MWD’s January budget document states that it includes a total authorized personnel complement of 1,907 (including 24 temp equivalents) for 2012/13 and 2013/14, with an assumed vacancy rate of 2.7% and 2.9%, respectively. This translates to 1,832 and 1,828 FTE for each of the two years, respectively. But staff reported to the board in February that it had 1,756 employees on its payroll – which would mean that MWD intends to hire 80 additional staff. A subsequent report by staff at the February board meeting said that applying the vacancy rate would result in 1,798 full time equivalents (exclusive of temps), which would mean that MWD intends to hire 42 additional staff.

exceeded revenues in three of the last four fiscal years. However difficult it is to explain to water ratepayers, we all know that fixed costs are not reduced with reduced sales – and, that it is essential that fixed costs be paid. But MWD’s proposed rate increases go far beyond covering fixed costs – the budget actually increases spending on projects that are not necessary at this time of reduced demand for MWD water.

This is why we recommend that conservation funding for the next two years be suspended. While we understand the popularity of these programs, these expenditures are simply not necessary to “incentivize” water conservation at a time when water sales are already down more than 30% at MWD and most retail water suppliers. Retail ratepayers are already being asked to fund the difference between fixed costs and the amount of revenue available from reduced sales. It isn’t fair – or even logical – to also ask our ratepayers to pay for even more water conservation right now – they need and deserve to take the “break” that suspension of these payments would provide in the form of lower water rates.

Renewed Call for Moratorium on Use of MWD Ratepayer Dollars to Pay for Member Agency Water Projects – MWD has also been relying on its outdated Integrated Resources Plan and unrealistic water sales projections to support its continued payment of MWD water ratepayer dollars to subsidize member agency water supply projects. These projects are not owned or operated by MWD, and MWD has no right to the water supply. MWD has failed to demonstrate that these payments benefit the customers of any member agency other than the agency receiving the payments. The bald statement that these projects “will strengthen regional

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5 February 14, 2012 MWD Board Letter 8-2, page 60, note 5 and attached Remarketing Statement.

6 Staff continues to rely on an outdated Integrated Resources Plan (IRP) and unrealistic sales projections to support its expenditures.

7 We note that although MWD continues to budget conservation at $20 million annually, its actual expenditures are significantly less. This is all the more reason to eliminate this spending from the proposed budget.

8 MWD should continue its conservation program except for the payment of financial subsidies. The Water Authority supports increased water conservation as part of a sensible, long-term plan that takes water rate impacts into account. Ratepayers are already highly motivated to conserve water due to higher water prices. MWD should not pay for state-mandated conservation requirements at the retail level. See Director Steiner’s August 15, 2011 letter to Mr. Foley re: Board Memo 8-7 – Adopt the Long Term Conservation Plan and revised policy principles on water conservation – OPPOSE. Finally, the Water Authority would support increased conservation investments by MWD – now and in the future – that are based upon a calculable demonstration of need and avoided water supply cost (e.g., reduced take from the Delta).

9 See Director Steiner’s October 11, 2010 letter to Chairman Brick re: Adoption of the 2010 Integrated Resources Plan – OPPOSE and attachments. MWD’s IRP is not a useful or realistic planning tool and cannot be relied upon to assess the need for water supply investments by MWD (and thus the benefits to MWD’s customers). Although the IRP stated that it would rely upon “adaptive management” to adjust to changed circumstances, MWD has failed to adapt to the fact that its water sales are down by more than 30%. MWD has also consistently failed to inform the public about the rising cost of water or include in its own planning the likely impact of higher water costs on demand for MWD water.

10 If the Water Authority is successful in its challenge of the Water Stewardship Rate to pay for these water supply projects, the costs will be redistributed to all other MWD member agencies and fall
water supply reliability,” absent a substantial factual basis and analysis connecting the facts to the conclusion, is insufficient to support MWD spending under Proposition 26 or other legal requirements.

**Stop Underwriting Peaking Costs of Los Angeles and Other Agencies** – The Water Authority has calculated that the annual benefit to the City of Los Angeles Department of Water and Power under the current MWD rate structure – resulting from MWD’s failure to identify and allocate the costs of annual peaking – is $35 million to $40 million per year. The Water Authority is not the only agency underwriting these costs – ratepayers from Orange County, Ventura County, Riverside County and San Bernardino County are also paying for LA’s annual peaking. This is because the current rate structure fails to account for the costs associated with annual peaking, including the cost of water, distribution and storage capacity necessary to serve these sporadic annual demands.¹¹

Many agencies, including the Water Authority, have some annual and seasonal peaking that is not accounted for in MWD’s cost of service. These costs should be identified and charged to the agencies that are benefitting from the investments necessary to meet their water supply needs. We raised this issue in our February 3, 2012 letter to Business and Finance Committee Chairman Grunfeld, copied to MWD’s General Manager and Chief Financial Officer (copy attached). Nearly one month later, on March 6, 2012 – after the budget workshops had already been concluded – we received a response from the CFO that did not address the substance of this issue, but stated that, the issue “is worded as a statement or position and should be addressed through the Board or Committee process” (copy attached). On March 8, we responded to the CFO’s letter, again presenting this issue in the form of a question. We asked,

Does the MWD cost of service currently capture and charge to the agencies that benefit, the full costs of system “standby” capacity and supply that enables year-to-year (annual) peaking off MWD?

We still have not received a response from the CFO, from MWD management or from the Chairman of the Board or Chairman of the Business and Finance Committee. Properly assigning these costs would result in additional water rate reductions for many ratepayers throughout MWD’s service area. We ask that you support our request at the April board meeting that this issue be addressed through the board or committee process, as suggested by the CFO – and, that adoption of rates be deferred until the board receives a full explanation why these costs are not accounted for or properly assigned in MWD’s cost of service. By copy of this letter, we are also disproportionately on the agencies – and their customers – that have not been rewarded with rich subsidy contracts.

¹¹ Staff’s February 17, 2012 presentation to the Member Agency Managers on the Proposed Biennial Budget, Revenue Requirements, and Water Rates and Charges Fiscal Years 2012/13 and 2013/14, slide 7, is incorrect. While it correctly states that additional physical capacity must be designed into the system and additional capital costs are incurred, and that these costs include portions of distribution and regulatory storage, it is incorrect in its statement that MWD’s capacity charge “recovers the costs of the system used to meet peak demands.” This is not accurate even as to seasonal peaking, let alone annual peaking, which is not accounted for in MWD’s cost of service allocations.
asking the General Counsel to advise us, in writing, whether she agrees with the CFO that the MWD board has the option, as a “policy” matter, to not charge the cost of the services, facilities and supplies attributable to annual peaking to the agencies that benefit.

SUMMARY

We urge the board to adopt a budget that caps the “average” rate increases at 3% for 2013 and 2014. Further, we recommend that the adoption of water rates and charges be deferred until MWD management has provided a cost of service analysis that properly accounts for and assigns all MWD costs – including the cost of annual peaking – to the agencies that benefit.

Sincerely,

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

Attachments:
1. Water Authority’s letter to MWD re biennial budget dated February 3, 2012
2. MWD response to Water Authority’s comment letter dated March 6, 2012
3. Water Authority’s response to MWD letter dated March 8, 2012

cc: Jeff Kightlinger, MWD General Manager
Gary Breaux, MWD Chief Financial Officer
Marcia Scully, MWD General Counsel
San Diego County Water Authority Board of Directors
March 12, 2012

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

Re: Oppose Local Resources Program Agreements – Board items:
7-4 – LADWP Chevy Chase Park and Los Feliz Golf Course
8-6 – LADWP Harbor Industrial Project
8-7 – LADWP Hansen Dam Golf Course
8-8 – LADWP Griffith Park
8-9 – Eastern MWD Landscape Irrigation
8-10 – West Basin MWD Seawater Barrier and Landscape Irrigation

Mr. Foley and Members of the Board,

We have reviewed the staff reports recommending board approval of six funding agreements under the Local Resource Programs (Board items 7-4, 8-6, 8-7, 8-8, 8-9, and 8-10). We oppose the use of MWD regional water ratepayer dollars to pay for these local supply projects of these member agencies, on the following grounds.

1) Preparation of the underlying data and cost of service and rate structure proposal purporting to justify these payments is the product of a broken governmental process, all as described in detail in the submittals the Water Authority has presented at the public hearing on MWD’s proposed water rates and charges for 2013 and 2014. As presented at the public hearing earlier this morning, the agencies that are the principal beneficiaries of these programs are draining millions of dollars from the pockets of water ratepayers in other cities and regions in favor of their own.

2) There is no credible basis established by the board memoranda or otherwise to support these payments. The mere statement that, “the project(s) would strengthen regional water supply reliability” is wholly insufficient to support the use of regional ratepayer dollars to pay for these agencies’ local water supply programs. Nor are these payments supported by any demonstration in the board memoranda or otherwise that these payments benefit anyone but the individual agencies to which payments are being made. There is no demonstration that any water supply or transportation costs are avoided by MWD as a result of these payments.

3) To the contrary, these payments harm all MWD water ratepayers by further reducing demand for MWD water and the revenues MWD depends upon for its very existence, and thus driving up the cost of MWD water supply for all other water ratepayers. MWD’s expenditures have
exceeded its revenues in three out of the past four years.¹ MWD’s lower sales are driving up the cost of water. Customers are angry because they are being asked to pay more at the same time they are using less. Rather than respond to these circumstances, MWD is further exacerbating the situation by paying some of its member agencies to buy even less water. MWD’s continued reliance on an outdated Integrated Resources Plan that includes bloated water demands that clearly do not exist – and are not reasonably projected to exist any time in the near future, if ever – is an insufficient basis to justify these payments.

4) As of August 2010, the MWD board took action stating that the Water Authority is no longer eligible to receive funds collected through its Water Stewardship Rate. As a result, and because no other direct or indirect benefit to the Water Authority and its customers is demonstrated, the rates and charges violate California law and may not be collected from the Water Authority’s customers.

5) Staff’s recommendation to the board to approve these projects is inconsistent with its own action in the public member agency process to suspend further discussions with the Local Resource Development Strategy Task Force, in order to reexamine the merits of this program and the water demand projections upon which it is based. Until that examination is completed, consideration of all local resource projects should be suspended.

6) The board memoranda proposing funding for these projects are insufficient to inform the board of directors of the costs associated with these projects. For example, Board Letter 8-9 (Eastern Municipal Water District) states that MWD’s share of the cost will be $2.3 million, but that it could go up to $31.3 million – almost 14 times higher. Similarly, Board Letter 8-10 (West Basin) states that the financial impact to MWD is $7 million, but that it could go up to $50 million – more than 7 times higher. The board has no way of knowing based on the Board Letters what the benefits and risks are, or what MWD’s financial exposure in connection with these projects will be.

The Water Authority would have no objection if the other MWD member agencies and the cities and customers they serve wish to subsidize the local water supply projects of the City of Los Angeles and other large agencies benefitting from this program. However, if they wish to do so, a separate fund that they pay into should be created for that purpose.

Sincerely,

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

cc: Jeff Kightlinger, MWD General Manager

¹ See February 14, 2012 Board Letter 8-2, page 60, note 5.
February 13, 2012

Board of Directors
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Re: Board Memo 8-2: Authorize the execution and distribution of Remarketing Statement in connection with the remarketing of the Water Revenue Refunding Bonds (Index Mode), 2011 Series A-1 and A-3, in the amount of $128,875,000

Dear Chairman Foley and Board Members,

We have reviewed Board Memo 8-2 including Attachments. For reasons we have described in detail in prior correspondence concerning the sale of bonds by Metropolitan – as well as in recent correspondence regarding the proposed budget (Attachment 1) – we are not comfortable that the Remarketing Statement as drafted by Metropolitan allows us to meet our legal responsibilities in voting to approve the draft Remarketing Statement. We must therefore respectfully vote against the staff recommendation.

We understand the need for the remarketing. And, we acknowledge the edits Metropolitan made in response to our comments on the last draft Appendix A (Attachment 2). However, we do not believe the edits went far enough to ensure that information essential to making an informed investment decision is being presented in a manner that is not misleading. The draft Remarketing Statement does not correct these deficiencies. In summary, the principle (but not exclusive) areas of concern remain the following:

- Failure to sufficiently describe the changed circumstances that have resulted in reduced demand for Metropolitan water.
- Failure to adequately describe the impact on water sales of conservation requirements and higher water rates.
- Risk associated with Metropolitan’s inability to secure long term purchase contracts or legal equivalent from its member agencies.
- Risk to Metropolitan of its heavy reliance on water sales revenues to pay its fixed costs.
- Failure to adequately describe the risks and costs associated with uncertainly and volatility of water purchases by City of Los Angeles.
- Risk associated with projecting water sales based on “average” pricing.
- Failure to reasonably estimate future water rate increases, generally, and as associated with Metropolitan’s Integrated Resources Plan as adopted by the Board.
• Impact of Proposition 26 on setting water rates and charges.
• Failure to describe impacts resulting from the fact that Metropolitan expenditures have exceeded revenues in three out of the last four years.
• Undue reliance on historical data to predict future outcomes in the current, changed water supply and fiscal environment.

While we are aware and have taken into account that the draft Remarketing Statement includes a number of “disclaimers” in these and other areas, we are concerned that certain of these disclaimers could be challenged because they relate to matters that could or should have reasonably been known by Metropolitan and its Board of Directors.

We do not come to this decision lightly. If Metropolitan and the Board wish to work with us to address our concerns, we will provide detailed comments on the draft Remarketing Statement. We note that we have raised these concerns repeatedly in the context of many different board actions, without receiving a substantive response.

Sincerely,

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

cc: Jeffrey Kightlinger, General Manager
    Gary Breaux, Chief Financial Officer
    San Diego County Water Authority Board of Directors

Attachments:
  1. February 3, 2012 letter re: MWD Budget and Rates
  2. August 22, 2011 letter re: Appendix A
February 3, 2012

Aaron Grunfeld
Business and Finance Committee Chairman
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

Re: Proposed Biennial Budget and Associated Rates and Charges for 2012/13 and 2013/14

Dear Mr. Grunfeld:

First, we want to thank you for your commitment to hold budget workshops so the board may review, ask questions and understand the proposed budget.

We have reviewed staff’s proposed biennial budget and associated rates and charges for 2012/13 and 2013/14, as well as the slides presented at the January workshop. Based on this preliminary review, we are providing you with the comments, requests and questions which are attached. In order to facilitate the board’s deliberation of these issues, we request that staff respond to our comments and questions in writing prior to the next budget workshop.

We look forward to continuing this important dialogue at the next budget workshop.

Sincerely,

Lynne Heidel
Director

Keith Lewinger
Director

Fern Steiner
Director

Doug Wilson
Director

Attachment

cc: Jack Foley, MWD Board Chairman
    Jeff Kightlinger, MWD General Manager
    Gary Breaux, MWD Chief Financial Officer
San Diego County Water Authority (SDCWA)’s MWD Delegates’ questions and comments on proposed biennial budget and associated water rates and charges for FY 2012/13 and 2013/14

All references are to Budget Memo 8-1 for the January 10, 2012 Board meeting or to the power point presentation at the January 24, 2012 budget and rate workshop.

1. **The Board must take steps to “right-size” MWD in order to ensure that revenues – based on more reasonable demand projections – are sufficient to pay MWD’s costs.**

   - MWD’s water deliveries declined almost 500,000 acre feet over the last four years from 2.26 million acre feet (MAF) in 2008 to 1.68 MAF in 2012. Moreover, the 2012 delivery figures included 164,000 acre feet of San Diego County Water Authority’s (Water Authority) QSA transfer water and 225,000 of “one-time” discounted water sales that would not have occurred at full price. MWD’s 2010 Regional Urban Water Management Plan (RUWMP) shows its average year sales in 2030 will be 22% lower than projected in MWD’s prior RUWMP just five years ago. MWD’s sales projections are flat or trending downward and yet, the Board has taken no meaningful actions, in terms of programs or staffing, to reduce the expense side of the budget to reflect this dramatic reduction in MWD sales.

   - What is basis of budget demand projections assuming full service sales of 1.5 MAF next year and in future years? The Board memo states that the sales estimate is “conservative,” yet, this assumption is 200,000 acre feet more than this and last year’s full service sales of 1.3 MAF.

   - MWD has not covered its operating costs in six out of the last eight years (2004-2011). The first order of business must be to reduce spending, consistent with budget cuts already implemented by most of the cities and retail agencies in Southern California.

   - Given that retail demand is down 20% or more across the MWD service area, we recommend a moratorium on all subsidy programs designed to further reduce MWD sales (and revenues). The moratorium should remain in place until MWD updates its IRP projections and conducts a comprehensive study to evaluate the need for MWD to pay for such programs. This recommendation should not be interpreted to suggest that the Water Authority does not fully support the development of local supply projects including increased water use efficiency, but rather, that funding should be at the local level.

   - The budget notes that replenishment water will be sold at full service rates, however, it does not appear to account for the cost of “incentives” or “rebates” that are also part of the staff recommendation for a revised replenishment program. Please identify the amount and cost of service category to which these incentives or rebates are assigned. What rate is proposed to generate the revenue to pay the cost of these incentives or rebates?

2. **MWD should reasonably spread cost burdens among current and future rate payers; it should not raid revenues intended for capital projects to pay operating expenses, and should not overburden future rate payers by deferring OPEB funding.**

   - The budget includes a reduction of PAYGo revenue collections in 2012/13 that is inconsistent with the Board’s adopted policy. If the Board approves this recommendation, MWD will have failed to follow its own PAYGo funding policy in eight out of the last ten years (2005-2014). Funding capital projects at such low PAYGo levels unfairly shifts obligations from current
ratepayers to future ratepayers. Moreover, several years of midyear reallocation of PAYGo funds intended for capital to meet operating expenses has distorted cost of service. The Board should not continue to apply revenues that are collected for capital projects to pay operating costs.

- The proposed budget continues to shift a disproportionate share of unfunded OPEB liability to future ratepayers. The funding schedule presented at the January workshop to begin ramping up payments to match MWD’s Annual Required Contribution (ARC) does not go far enough. MWD should cut costs now in order to increase funding to match its ARC.

- A greater share of MWD’s Capital Improvement Program (CIP) now consists of R&R projects. Indeed, the January workshop presentation showed R&R expenditures represent about two-thirds of CIP costs over the two years reviewed. Aside from the misuse of PAYGo to pay operating expenses, we also suggest that the Board consider changing its PAYGo funding strategy so it is proportionate to the total CIP over time. This would ensure that current ratepayers are not being asked to pay a disproportionate share of R&R.

3. **MWD must properly account for the cost of storing water.**

Based on data assembled from the proposed budget, the supply and delivery balance is as followed:

<table>
<thead>
<tr>
<th>Supply/Demand</th>
<th>2012/13</th>
<th>2013/14</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Water Project (Exchange)*</td>
<td>1,260 TAF</td>
<td>1,140 TAF</td>
</tr>
<tr>
<td>Net to MWD</td>
<td>1,140 TAF</td>
<td>1,032 TAF</td>
</tr>
<tr>
<td>Colorado River**</td>
<td>727 TAF</td>
<td>890 TAF</td>
</tr>
<tr>
<td>Total supply to MWD service area</td>
<td>1,867 TAF</td>
<td>1,922 TAF</td>
</tr>
<tr>
<td>Total MWD demand**</td>
<td>1,700 TAF</td>
<td>1,700 TAF</td>
</tr>
<tr>
<td>Excess supply</td>
<td>167 TAF</td>
<td>222 TAF</td>
</tr>
</tbody>
</table>

*The budget document does not describe the exchange; if this is not MWD’s exchange obligation with Coachella and Desert Water, please provide details.

**The budget document includes Water Authority’s QSA water at 172.7 TAF and 177.7 TAF for 2012/13 and 2013/14, respectively, as both supply and demand. MWD does not report the local water supplies and associated demand of its other member agencies, and has no basis for treating Water Authority’s QSA water differently. In accordance with the terms of the Exchange Agreement, the revenues generated from payments made under the Exchange Agreement should be treated as transportation or wheeling revenues.

- Staff reported at the workshop that it plans to store 300,000 acre feet of water this year, which is more water than is estimated to be available for storage in the supply and delivery balance. What is the source of the water staff is planning to store, and, how are the costs of that water captured in the cost of service? How much funding is included in the budget to pay for storage costs? Finally, is the energy cost of moving the water into storage being captured in the System Power Rate or through Supply Programs?
4. **The cost of service does not recover the costs of system “standby” capacity and supply that enables year-to-year peaking off MWD.**

   - Many agencies peak off the MWD system from year-to-year, depending on hydrology and the availability of local water supplies. MWD has developed and continues to develop water supplies and incur storage and facility costs in order to meet these demands, but is not fully allocating the costs associated with these investments from the agencies that benefit from them. MWD must change its rate structure in order to account for and allocate these costs so that they are borne by the agencies that benefit by being able to peak and then roll off the MWD system.

5. **The Delta Supply Surcharge should be continued because the purpose for which it was established by the Board has not changed.**

   - Please provide the basis of the staff recommendation to delete the Delta Surcharge. Given the rationale stated in Board Memo Revised 8-3 dated April 14, 2009, the Delta Surcharge should remain in place. In fact, the budget states at page three that increased funding is being included to aggressively pursue exactly the type of projects the Delta Surcharge was intended to cover.

   - Was the Delta Supply Surcharge combined with the Tier 1 supply rate? If not, how were these costs reassigned?

6. **Staff needs to provide more information why individual rate components are increasing or decreasing; and, take steps to better smooth rate increases at the retail level.**

   - The proposed individual rates and charges include changes that vary significantly from the “average” 7.5% increase staff reports. Since no agency pays “average” rates, information needs to be provided on why individual rates and charges are increasing or decreasing. Please provide the data supporting the System Access Rate increases. Also, please provide the data supporting the supply rate decrease.

   - Staff should also explain why some elements show decreases one year and increases the next year – or vice versa, and, present alternatives to avoid swings in the rates and charges.

7. **Staff must track all rate component costs and expenditures, not just the Water Stewardship Fund.**

   - MWD tracks over- and under- expenditures for revenues collected under Water Stewardship rate, but not others. What is the basis for this disparate treatment? For example, although MWD has a Treatment Surcharge Rate Stabilization Fund, when fund revenues are insufficient to pay those costs, MWD uses General Fund revenues to cover the difference. The net effect is that raw water customers are subsidizing treated water customers. We request that MWD provide a cost of service analysis for all rate components and identify or develop internal tracking mechanisms to prevent cross-subsidies.
8. All operations and staffing should be “right-sized” to reflect reduced demands.
   • What were staffing levels and budget in 2008? What are they today?
   • What criteria has staff used to “optimize” staffing levels?
   • Are the staffing levels recommended in the budget higher than current actual levels? If so, why?
   • Please provide a list of the O&M association dues that total $5 million annually.

9. A contingency plan should be included in the proposed budget.
   • The biennial budget should include a contingency plan that would automatically be triggered mid-year to reduce current costs in the event projected revenues are lower than budgeted.
   • Similarly, the budget should provide a plan that describes in detail how MWD will apply excess funding in the event projected revenues exceed expenditures. This is especially important in light of the recent draw-down of reserves, raids on the PAYGo fund and cross-subsidies that have been created by the failure to track individual rate components – or to budget so that projected revenues are reasonably expected to be sufficient to pay MWD’s expenses.

10. Even if it is unwilling to update or modify its cost of service analysis generally – which it should – MWD must at a minimum provide a new cost of service analysis to ensure compliance with Proposition 26.
   • Even if the Board does not require staff to update or modify its cost of service analysis, or, support a moratorium on local projects spending to mitigate the impacts of reduced demands and MWD revenues, staff must identify the benefits it claims are associated with these payments and demonstrate that those benefits are received by those paying the charges and that the amount of the charge is reasonably related to the benefits. The benefits that have been stated but which have not been supported by any data or analysis include (1) capacity will be made available that is otherwise not available for the transportation of MWD water; (2) investments MWD would otherwise need to make in other facilities and/or water supply will be avoided as a result of these payments; and (3) MWD needs and will benefit from the local water supply it is paying for. Please provide the analysis required by Proposition 26.
December 13, 2011

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

Re: SB 60 Annual Public Hearing and Report to the Legislature Regarding Adequacy of MWD’s Urban Water Management Plan
REQUEST TO INCLUDE INFORMATION IN REPORT TO LEGISLATURE

Dear Chairman Foley and Members of the Board of Directors:

We request that this letter and all of its attachments be made a part of today’s board record and included in MWD’s Annual Report to the Legislature regarding the adequacy of MWD’s Urban Water Management Plan to achieve increased emphasis on cost-effective conservation, recycled water and groundwater recharge as described in the MWD Act.

As background to yesterday’s public hearing on this subject, the Water Authority prepared and submitted to MWD a short PowerPoint presentation that was not allowed by Mr. Kightlinger to be shown to the board of directors. MWD staff also refused to distribute hard copies of the presentation to the board in accordance with the usual practice as stated on the speaker’s request form; because of these refusals, San Diego Director Lewinger distributed the copies. We were not aware at the time of the hearing that the Water Authority’s PowerPoint had already been loaded on the MWD computer, or we would have objected at that time. Water Authority staff was also informed yesterday that no presentations may be made to the MWD board unless they are first reviewed and approved by MWD management. We do not believe that MWD may place any such prior restraint on the content of material proposed to be presented at any public meeting of the MWD board of directors. As Chair, you undoubtedly know that the Brown Act expressly states that “a local agency shall not prohibit public criticism of the policies, procedures, programs, or services of the agency, or the acts or omissions of the legislative body.” (Government Code § 54954.3 (c).)

Copies of the Water Authority’s PowerPoint presentation, written testimony by Assistant General Manager Dennis Cushman and a report by Gordon Hess and Associates titled, Comparison of MWD Demand Projections, Member Agency UWMPs and Local Water Supply Development Plans (Hess Report), are attached. As you know, for the reasons described in Mr. Cushman’s testimony and attachments, we believe that MWD focused on the wrong question at yesterday’s public hearing and in its draft Report to the Legislature by limiting it to a report on MWD subsidy programs.
We also request that MWD inform the Legislature about its “Rate Structure Integrity” (RSI) “policy” and clause, which may be used by MWD to terminate all MWD funding agreements for conservation, recycled water and groundwater recharge in the event that agency challenges MWD’s water rates in court or before the Legislature. Further, MWD should include in its SB 60 report that the MWD board has, in fact, terminated, with limited exception, all of the Water Authority’s funding agreements that contain the RSI provision, and refused to enter into future funding agreements supporting conservation, recycled water and groundwater recharge in San Diego County. (A copy of MWD’s June 23, 2011 to the Water Authority is attached.) MWD has essentially blackballed the Water Authority from participation in these programs, in spite of the fact that it continues to collect more than $16 million annually from San Diego County water ratepayers to pay for these programs. MWD should also inform the Legislature that the Water Authority is challenging MWD’s actions and the constitutionality and legal propriety of the RSI clause in the lawsuit now pending in Superior Court in San Francisco.

For the reasons described in Mr. Cushman’s testimony and in the Hess Report, we do not believe that MWD has done the analyses necessary – either in its 2010 Integrated Resources Plan (IRP) or 2010 Regional Urban Water Management Plan (RUWMP) to support and enhance water conservation, recycled water and groundwater recharge in Southern California. Indeed, the greatest impediment may be the very perpetuation of the notion that these projects will only be developed if MWD subsidizes them. Conservation is at an all-time high throughout the Southland as a result of the higher water rates being charged by MWD and its member agencies. More local water supply projects are being developed because they have become cost-competitive due to the higher water rates being charged by MWD. It is clearly time for a fresh and realistic look at MWD’s demand and rate projections and to tie future resource planning directly to the willingness and firm financial commitment of its member agencies to pay.

Sincerely,

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

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

Attachments:
1. Water Authority’s PowerPoint Presentation to MWD WP&R dated December 12, 2011
2. Water Authority Assistant General Manager Dennis Cushman’s testimony
4. MWD June 23, 2011 letter to Water Authority
November 4, 2011

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

Re: Board Memo 8-8 – Approve Policy Principles for a Replenishment (Discounted Water) Program

Dear Chairman Foley,

Board Memo 8-8 asks the board to approve policy principles to guide the development of a new program for the sale of discounted water. We do not believe that the policy principles as proposed by staff provide a sufficient and clear basis to guide the development of a new program. Indeed, we do not believe that the staff has established the need for a new program to sell discounted water, whether it is described as “replenishment,” “regional water management,” or otherwise.

We have raised a number of questions over the past several months, since the General Manager first proposed the sale of discounted water last April. Our concerns have focused on the unprecedented budgetary and fiscal challenges confronting Metropolitan, including the fact that its expenditures have exceeded revenues in six out of the last nine years. Over the last four years, Metropolitan has resorted to raiding funds intended for pay-as-you-go capital expenditures in order to meet normal operational expenses. The discounted water program is a concern because when Metropolitan sells water at a discount, it displaces full-rate water sales, which in turn leads to lower revenues overall and insufficient recovery of fixed costs.

While the staff continues to bring back recommendations based on the wishes of the member agencies, it has failed again to address the needs of Metropolitan. We understand why the member agencies would like Metropolitan to sell them water at a discount, what we do not understand is how the Metropolitan staff proposes to ensure benefit to all member agencies when discounted water is sold to some, or, how Metropolitan will be in a position to reverse its declining financial condition through the sale of discounted water.

The analysis provided in Board Memo 8-8 fails to address the very concerns raised by staff in its April 26, 2011 Board Memo (5-1) that first recommended reinstituting the sale of discounted water. Those concerns included – and remain:

A public agency providing a safe and reliable water supply to the San Diego region
Chairman Foley  
November 4, 2011  
Page 2

- Questionable and unquantifiable performance criteria for a discounted water program;
- Loss of full service sales due to availability of discounted water;
- Unequal distribution of costs and benefits among member agencies; and
- Cash flow and budget issues associated with availability of discounted water.

The staff has also failed to respond to questions about Metropolitan’s existing storage programs or the assumptions it is making about the use of that storage in the future. As a result, there is no basis for determining either the need for, or benefit of another new program.

We are attaching our past communications to the board on this subject. We request that staff respond, in writing, to the questions asked in our letters. Doing so would provide the board with a sound foundation to discuss the real policy principles involved in the proposed sale of discounted water. We would appreciate a written response to our letters in any event because they raise issues and concerns of great interest to our member agencies and water ratepayers.

Sincerely,

Lynne Heidel  
Keith Lewinger  
Fern Steiner  
Director  
Director  
Director

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

Attachments:
1. April 25, 2011 letter to Jack Foley re: Board Memo 5-1 – Sale of Discounted Water and Attachment 1: Issues Associated with the Sale of Discounted Water by MWD
2. May 6, 2011 letter to Jeff Kightlinger re: Board Memo 5-1 – Sale of Discounted Water
3. September 12, 2011 Comments and Questions on Board Memo 9-2 – Update on Replenishment Service Program, Director Keith Lewinger
4. October 7, 2011 letter to Jack Foley re: Water Planning and Stewardship Committee Items 6a, 6b, and 6d
October 25, 2011

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

Re: KPMG Audit Report of MWD’s Basic Statements for Years ended June 30, 2011 and 2010

Dear Chairman Foley:

The Auditor’s report states that it is prepared in accordance with Government Auditing Standards. Though these standards do not require the presentation of budgetary information for Enterprise funds, it would be extremely helpful for this information to be presented as supplemental information in the Comprehensive Annual Financial Report (CAFR) following the notes to the financial statements, so it could provide a context for evaluating evidence and understanding of findings, conclusions and recommendations in the report.

Referring to page 13, the information on future debt service is misleading as it does not include projected future debt issuance. It should be noted that it does not include projected future debt issuance.

In the CAFR transmittal letter it would be prudent to disclose the potential impacts of Proposition 26 on revenue policies, in particular, that the collection of revenues under the current policy for conservation and Local Resource Programs may not meet Proposition 26 or other legal requirements.

Referring to page 58, Bay Delta discussion mentions it is expected that the BDCP will be approved, and a permit decision will be made in 2012, but the report should disclose the potential cost impacts to MWD of the BDCP plan.

Referring to page 60, SDCWA litigation disclosure mentions that the Exchange Agreement requires MWD pays the disputed portion paid by SDCWA if the Water Authority prevails, but it should also disclose that in accordance with the Exchange Agreement MWD is required to escrow the disputed funds each year until the litigation is completed.

Referring to page 69, the discussion should disclose that there is an escrow account for the SDCWA litigation, identify where it is held and that as well as any implications for reserve fund Board policy minimums.

A public agency providing a safe and reliable water supply to the San Diego region
We request that management respond in writing to the issues identified in this letter.

Sincerely,

Jim Bowersox  
Director

Lynne Heidel  
Director

Keith Lewinger  
Director

Fern Steiner  
Director

cc: MWD Board of Directors
October 7, 2011

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

Re: Water Planning and Stewardship Committee items 6a, 6b, and 6d

Dear Chairman Foley,

We have reviewed the staff reports to be discussed under Committee items 6a, 6b and 6d at the October 11, 2011 Water Planning and Stewardship Committee. The reports provide a long list of activities described as implementation of the 2010 Integrated Resources Plan (IRP) including BDCP and other imported water projects, recycled water projects, conservation, seawater desalination and, the sale of discounted water. What is absent from the reports is any analysis showing:

• The demand for all of the water that will be produced by these projects;
• The rate increases associated with implementation of all of these projects;
• The regional benefit (to all member agencies paying the rates) of payments by Metropolitan for some member agency local water supply projects;
• The regional benefit (to all member agencies paying the rates) of the sale of discounted water by Metropolitan at a time when its water sales are more than 25 percent lower than projected and water rates are far higher than projected in Metropolitan’s adopted Long Range Finance Plan; or
• How all of these projects are expected to be paid for.

Almost twenty years ago, the Metropolitan Blue Ribbon Committee Task Force urged Metropolitan to fully integrate its resource planning and rate structure efforts because, “reliability, cost and demand are all interdependent and should be treated that way in the IRP and rate structure reform processes” (page 9). Unfortunately, Metropolitan has steadfastly refused to do so – as reflected in this month’s board reports of ongoing project implementation without any discussion whatsoever about cost or demand. Metropolitan’s stubborn refusal to reduce its spending and operations is inconsistent with the economic reality today facing every city and water retailer in Southern California.

The IRP states that it is based on “adaptive management.” It is time now for Metropolitan to “adapt” to actual, changed circumstances including dramatically reduced sales, dramatically
reduced projected demand for Metropolitan water, and, rapidly escalating water rates that will further dampen demand for Metropolitan water.

Since 2003, Metropolitan’s expenditures have exceeded its revenues for six out of nine years, and for the same number of years, it has diverted funds intended for pay-as-you-go capital projects to pay for operational expenses. Metropolitan’s financial reserves are being depleted, and now stand at their lowest level in 20 years. Metropolitan must stop analyzing project implementation in a vacuum and on a piecemeal basis.

The rate increases associated with declining sales and new projects are inevitable. The impacts of these rate increases are already being felt throughout Southern California. We strongly urge Metropolitan to cease entering into any new project funding agreements and cease the sale of discounted water until Metropolitan staff and board update IRP demand projections to reflect current realities.

Metropolitan needs a rate structure and long-term financial plan that are fully integrated with realistic demand projections. Metropolitan must conduct a cost/benefit and cost of service analysis to justify both the investment of regional ratepayer dollars in member agency water supply projects and the sale of water at a discount. Not only is this required by law, but it is sound fiscal planning that is essential at a time when Metropolitan’s revenues are clearly insufficient to pay for its current costs and programs.

Sincerely,

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

Cc: MWD Board of Directors
Jeff Kightlinger
August 22, 2011

Board of Directors
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Dear Chairman Foley and Members of the Board:

We have reviewed Appendix A of MWD’s Draft Official Statement, distributed to the members of the board on August 15 relating to the upcoming refunding of certain fixed revenue bonds (Draft or Appendix A). While we support MWD’s desire to take advantage of the market to reduce its debt obligation, we remain concerned that MWD’s financial condition is not accurately described in Appendix A. As you know, the Water Authority’s MWD representatives have sent three prior letters regarding Appendix A dated September 22 and December 9, 2010 and May 16, 2011, copies of which are attached as Attachments 1-3, respectively, and incorporated herein by reference. Although MWD made specified changes as described in response letters dated September 23 and December 13, 2010 and email dated May 24, 2011, respectively, we do not believe that MWD has adequately addressed the stated concerns or that the August 15, 2011 Appendix A fairly presents MWD’s financial position currently or prospectively. We request that the Draft be modified to address these concerns in order to provide adequate disclosure to potential investors.

The Water Authority has previously raised many of the questions and concerns noted in this letter in prior written communications with MWD. These past communications include but are not limited to letters regarding the budget, dated April 11, 2011; adoption of the Long Term Conservation Plan, dated August 15, 2011; and, Member Agency Willingness to Sign Take-or-Pay Contracts and Request to Correct the Record of July 12, 2011 MWD Board of Directors Meeting, dated August 16, 2011. A copy of each of these letters is attached again for consideration by you and the other members of the board, MWD’s management team, General Counsel, outside bond counsel, underwriter’s counsel and other members of the financing team (Attachments 4-6, respectively). Unfortunately, MWD has not responded to our letters directly or indirectly by addressing the issues on the merits in changed MWD board policy or management actions.

In addition to the concerns that are described in this past correspondence, which we request you address in your response to this letter, we have the following specific comments on the Draft.

Appendix A, as a whole, fails to adequately describe the financial impacts associated with reduced water sales. Although the Draft discloses that its member agencies are not required to purchase any water from MWD (page 27), the Draft fails to describe the associated risk to MWD, or, its inability to secure long term purchase contracts or other firm financing commitments that are not subject to change by the board of directors to meet its current and future fixed obligations.

Although the Draft includes a section titled, “Regional Water Resources” (beginning at page 27), the
Chairman Foley and Members of the Board
August 22, 2011
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Discussion does not make clear what MWD’s role is – or is not – in developing local water supplies. Many of the projects noted as “Regional Water Resources” will actually be developed at the local level without any involvement by MWD and, thus, further reduce MWD water sales in the future. The Draft should disclose that local water supplies have become much more cost-competitive as a result of the increasing cost of MWD’s imported water and that as a result, many MWD member agencies are now pursuing the development of local water supply alternatives.

In addition to the development of local water supplies described above, the escalating cost of MWD water will likely result in reduced sales in the future. The Blue Ribbon Committee Task Force noted this more than 15-years ago. However, MWD continues to present analyses that do not consider the cost of water as a feature that will dampen future water sales. See, for example, Management’s Discussion of Historical and Projected Revenues and Expenditures at page 71 (future sales forecasts will reflect “a return to more normal weather conditions, a recovering economy and population growth, notwithstanding impacts of conservation and projected increases in water rates” (emphasis added). The Draft appears to mistakenly rely on past history as an indicator of future MWD sales (page 27) rather than assessing the dramatically changed circumstances confronting MWD.

Although the state legislature has mandated 20% conservation by 2020, MWD’s IRP, recently adopted Long Term Conservation Plan and Appendix A do not describe any impact on MWD water sales. In fact, the Draft states that MWD water sales will return to historic levels at 2 million acre feet beginning in fiscal year 2013-14 “notwithstanding impacts of conservation” (page 71). The Draft should explain how sales are expected to continue at these levels at the same time the retail agencies in the MWD service area are achieving 20% conservation.

Although the Draft discloses the Water Authority’s purchase of conserved water from IID and the water it has developed from lining the All-American and Coachella Canals, the Draft describes MWD’s transportation of this water under the Exchange Agreement as an MWD water sale. This characterization is misleading and disguises the true fact that MWD water sales have been reduced by the amount of water the Water Authority has independently secured from these sources.

The discussion of the Water Supply Allocation Plan (WSAP) (page 26) is also misleading in that it does not state that Preferential Rights is the statutory method for allocating MWD water during a time of shortage. Preferential Rights is discussed briefly much later in the Draft (page 50) but the two topics are not tied together. The discussion of Preferential Rights should also make clear that any “use” of Preferential Rights is at the discretion of the member agencies that hold the rights, not MWD.

The Draft should connect the discussion of Regional Water Resources (beginning at page 27) with the discussion of both MWD revenues (page 41) and Management’s Discussion of Historical and Projected Revenues (page 70) (Management Opinion). While MWD continues to project returning sales of 2 million acre feet, its discussion of seawater desalination programs alone shows potential reduced sales of almost 400,000 acre feet, exclusive of the many other local water supplies that are now being developed throughout the MWD service territory.

All of the information relating to the sale of discounted water is in the section on resources (page 30). The Draft should be revised to tie this discussion to Revenues (beginning at page 41) and should also be addressed in Management’s Opinion. By its own report, MWD chose to sell water at a discount in part because its member agencies would not pay full service rates for replenishment
Chairman Foley and Members of the Board
August 22, 2011
Page 3

water. See MWD Board Memo dated May 10, 2011, a copy of which is attached, explaining that MWD water sales would only increase if water is sold at a discount due to the “budgetary or other financial constraints that the member agencies have” (Board Memo at page 3) and that offering water at full service rates would not “significantly increase the demand for replenishment water.” And yet, as noted above, the Draft excludes consideration of the impact of the cost of water on future MWD water sales. The Draft should describe how MWD’s sale of discounted water reduces full service water sales – reduces water sales revenues – and causes the cost of MWD’s full service water to escalate even higher as the true costs are spread among an even lower sales base.

In its May 10, 2011 Board memo recommending the sale of discounted water as replenishment sales, MWD staff asserted that the sales would increase current year (FY 2012) net revenues by $57.8 million (see “Options 3 and 4 Replenishment Service Program,” top of page 5). In their ratings reports in May 2011, the rating agencies relied on the promise of additional revenues from replenishment sales to help improve MWD’s fiscal position. However, four months into this eight-month discounted water sales period, MWD is not realizing “positive Net Revenue” as the board memo forecast. On the same day MWD staff released this Draft Appendix A for review by the board, our board heard reports in the Finance and Insurance Committee and the Engineering and Operations Committee that, taken together, foretell that the discounted water sales program will result in a net revenue shortfall of approximately $30 million in the current year, assuming 225,000 acre-feet of discounted water is sold by the end of December. In the Business and Finance Committee, the Board was informed that current year water sales are projected to fall short of budget projections by 13,000 acre-feet (assuming a budget based upon 1.8 MAF of sales; the Draft Appendix A says MWD’s FY 2012 forecast was for 1.85 MAF of sales). In the Engineering and Operations Committee, the Board was informed that MWD has already sold 118,000 acre-feet of discounted water, and has demands from the member agencies for 323,600 acre-feet of discounted water. Thus, it appears that projected sales of 1.787 MAF includes assumed sales of 225,000 acre-feet of discounted water. As we warned last May, discounted water sales are cannibalizing full-rate water sales, and will lead to a revenue shortfall this fiscal year of $30 million on the differential alone. This represents a nearly $90 million shift from the MWD staff prediction in May of “positive Net Revenue” of $57.8 million as a result of discounted water sales. MWD is likely to end FY 2012 with yet another revenue shortfall, making it the fourth year out of the past five years in which revenues were not sufficient to cover expenditures.

The Draft should include a discussion and cost estimate for the BDCP and potential impact on water rates. These projected costs of MWD’s imported water supplies are the measure by which current decisions are being made to invest in alternative local water supply development and are having an impact now on MWD water sales.

The Draft discloses the ongoing draw down of reserve balances in its discussion of the Capital Investment Plan (page 37), but does not tie these trends into Management’s Opinion. The Draft should also disclose the amount of the reserves that are currently held in escrow as a result of the San Diego County Water Authority litigation as well as amounts projected to meet future escrow requirements and the impact this will have on reserve balances.

The Draft should disclose that MWD has had the same external financial auditor for more than 19 years. Further, that a question has been raised regarding MWD’s treatment of its State Water Project contract for accounting purposes (see discussion at page 63).
The Summary of Receipts by Source (page 42) and Summary of Water Sold and Water Sales Receipts (page 43) should disclose receipts for the transportation of water by MWD. Although footnote 3 (page 44) states that “water sales” includes wheeling, the sale of water and the transportation of water are two completely different service functions.

The Draft’s Summary of Water Sold and Water Sales Receipts (page 43) also fails to disclose important information by reporting “Average Receipts Per Acre Foot.” Since no water is sold by MWD at “average” rates, MWD should disclose the amount of water it sells at full price and under discounted water programs.

The Draft should include a more detailed explanation of current and potential litigation. MWD is on notice of the additional claims the Water Authority intends to file including Rate Structure Integrity, Preferential Rights and Breach of Fiduciary Duty. The Water Authority has also informed MWD that it does not believe that current conservation and Local Resources Programs meet Proposition 26 or other legal requirements. The Water Authority has informed MWD that it does not believe that there is a legal basis for the sale of discounted water to some but not all MWD member agencies. Although the litigation is disclosed in the Draft (discussion of the rate structure at page 45), the litigation should also be noted in the discussion of MWD’s Principal Customers (page 49).

Agricultural water sales are discussed in the section entitled, “Classes of Water Service,” but should be tied to both Revenues and Management’s Opinion on future water sales. The Draft should note that agricultural water sales have historically accounted for as much as 150,000 acre feet or more of MWD’s total annual sales, but were less than 35,000 acre feet in 2010. Most of the water sales under the Interim Agricultural Water Program were to customers of the San Diego County Water Authority and are not expected to continue at full service rates when the IAWP terminates on January 1, 2013.

The Draft taken as a whole does not disclose the financial impacts to MWD of significantly reduced future water sales by MWD. The projected sales decline is significant. MWD’s 2000 Urban Water Management Plan (UWMP) projected that MWD would sell approximately 2.3 million acre-feet of water in 2020 (average year demand). By the time of its 2005 UWMP, MWD revised the 2020 projection downward to approximately 2 million acre-feet. MWD’s 2010 UWMP – adopted nine months ago – again lowered the 2020 projection, this time to 1.66 million acre-feet. In all, MWD’s current projected (average year) sales for 2020 are nearly 30 percent lower than it projected just 10 years earlier. The factors contributing to reduced MWD water sales are not accurately described in Appendix A.

The Draft notes in a footnote that disbursements exceeded revenues in the fiscal years ended June 30, 2008, 2010 and 2011. This is a material factor that should be discussed more fully in the Draft and included in Management’s Opinion, particularly in light of the likelihood that expenditures will once again exceed revenues in FY 2012.

For the reasons described above and in the Water Authority’s letter on the budget (Attachment 4), we do not believe that the projection of MWD’s water sales and water rates described in Management’s Opinion (page 68) are reasonable. We believe sales will be substantially less than described and that water rates will be substantially higher than described.
Please contact me if you have any questions.

Sincerely,

Keith Lewinger, on behalf of San Diego County Water Authority
Representatives on the MWD Board of Directors

cc: Jeffrey Kightlinger, General Manager
    Thomas DeBaker, Interim Chief Financial Officer
    San Diego County Water Authority Board of Directors

Attachments:
1. September 22, 2010 letter re: Appendix A
2. December 9, 2010 letter re: Appendix A
3. May 16, 2011 letter re: Appendix A
4. April 11, 2011 letter re: MWD Budget
5. August 15, 2011 letter re: Adoption of Long Term Conservation Plan
6. August 16, 2011 letter re: Member Agency Willingness to Sign Take-or-Pay Contracts and Request to Correct the Record of July 12, 2011 MWD Board of Directors Meeting
7. MWD Board Memo dated May 10, 2011 re: Sale of Discounted Water
August 16, 2011

Mr. Jeffrey Kightlinger  
General Manager  
Metropolitan Water District of Southern California  
P. O. Box 54153  
Los Angeles, California 90054-0153

Re: Member Agency Willingness to Sign Take-or-Pay Contracts  
Request to Correct the Record of July 12, 2011 MWD Board of Directors Meeting

Dear Mr. Kightlinger:

During discussion of your business plan at the MWD Board of Directors meeting on July 12, 2011, Water Authority Director Lewinger asked if you would incorporate into your business plan several suggestions, including one specifically suggesting MWD secure take-or-pay contracts with its member agencies. In response, you stated that “...with respect to securing Board approval of firm take-or-pay contracts, we discussed this for two years in 2000-2002 and staff comments of the Water Authority at the time were against take-or-pay contracts.” Your statement is incorrect. In fact, the Water Authority has a long track record advocating that MWD obtain long-term take-or-pay contracts with its member agencies in order to stabilize its revenues and improve its fiscal sustainability. Indeed – please correct us if we are wrong – the Water Authority is the only MWD member agency that has indicated a willingness to make a firm funding commitment to pay for MWD spending programs.

Fifteen years ago, in 1996, the Water Authority made a proposal for a take-or-pay contract as outlined in its “Summary of Proposal to Resolve Colorado River and Rate Refinement Issues, dated April 22, 1996” (Attachment 1).

Later, as a part of the rate restructuring process for years 2000-2002, the Water Authority Board of Directors adopted, and then formally submitted a proposal to MWD’s Board of Directors entitled “Framework of Key Contract Terms, dated February 17, 2000” (Attachment 2). The basic premise of the framework was that member agencies should specify by contract the water and services MWD would provide and a formula by which the agency agrees to pay for the water and services. Details of a take-or-pay contract between the Water Authority and MWD are included in Attachment F of the proposed framework. The framework sought to address many of the fiscal challenges that existed then, but which have grown far worse over the past decade. We asked the question at that time, on page 6, item 8: “Given the magnitude of its expenditures, is there any legally enforceable method other than take-or-pay contracts that can provide MWD with the certainty it needs to assure its fiscal integrity and stability?”
As these documents – and many other comments by the Water Authority’s staff and MWD delegates over the years – reflect, the Water Authority has long advocated that take-or-pay contracts with MWD’s member agencies are necessary to address deficiencies in its revenue structure. Specifically, MWD continues to incur more and more fixed costs and debt obligations – amounting to more than 70 percent of its total costs – at the same time it has no financial commitments from its member agencies to pay for these costs. Instead, MWD continues to rely upon revenues from water sales, which today provide approximately 80 percent of MWD’s revenues and yet are highly variable. The gulf between MWD’s fixed expenses, at 70 percent, and fixed revenues, at 16 percent, is a key reason why MWD is in the worst financial crisis in its history.

More than 15 years ago, the MWD Water District Blue Ribbon Task Force (Blue Ribbon Task Force) found that the “greatest challenge” confronting MWD was the disconnect between its water supply planning process and its member agencies’ actual willingness to pay (or not pay) for MWD programs (see generally, Task Force Report, The IRP/Rate Structure Process and MWD Decision Making at pages 5-9 and The Integrated Resources Planning (IRP) process at pages 10-15). The Blue Ribbon Task Force found that:

- “An effective rate structure should generate sufficiently stable revenues to cover fixed costs” (page 15); and noted 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.” (Page 23.)

In order to address MWD’s long term fiscal sustainability, the Blue Ribbon Task Force recommended that MWD’s rate structures should ensure coverage of fixed costs without substantial modifications based on water use or other variable factors (page 20).

More than 15 years have now passed since the Water Authority and Blue Ribbon Task Force independently recommended that MWD adopt fixed payment commitments to address the growing instability of MWD’s financial structure. At that time, the Blue Ribbon Task Force warned that, “[c]omprehensive rate structure revisions should not be further delayed, and pressing MWD revenue needs should be addressed as soon as possible.” (Page 21.) Unfortunately, as you noted during your August 10, 2010 IRP presentation in San Diego (full quotation is included at Attachment 3), the rest of MWD’s member agencies “…prefer it the way it is” and remain unwilling to sign take-or-pay contracts or other firm funding commitments to pay for MWD spending programs.

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1 A second Blue Ribbon Committee was established by the MWD Board of Directors in January 2010. It has issued a Report, dated April 12, 2011, which has not yet been addressed by the MWD Board of Directors. Although the principal purpose of the 2011 Blue Ribbon Committee was to consider trends and uncertainties over the next 50 years that could affect MWD, it noted the importance of ensuring that the MWD rate structure provide a stable level of revenues to cover fixed costs – and, that if MWD’s member agencies find they can procure water more cheaply and reliably from other sources, they will reduce their purchases from MWD. See generally, Report of the Blue Ribbon Committee dated April 12, 2011, Finances and Pricing, at pages 73-76.
At the same time the MWD board has refused to ask or require MWD’s member agencies to commit to pay for MWD spending programs, it continues to adopt business and water resource plans that include massive spending for future State Water Project Bay Delta Conservation Plan costs, Integrated Resources Plan capital spending and long-term subsidy expenditures. While the Blue Ribbon Task Force appreciated the risk that was apparent more than 15 years ago (“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” (page 23)), MWD appears now to be reaching the breaking point due to reduced demands and implementation of member agencies’ ongoing plans to buy less water from MWD. MWD’s downward fiscal spiral is being hastened by the approval of more and more subsidies to its member agencies that will lead to even lower MWD sales – and revenues. Furthermore, the resumption of discount water sales by MWD in May of this year, which are displacing full service sales, will lead to even lower water sales revenues and continued operating budget shortfalls as MWD’s spending is not curtailed to match its lower water sales.

While MWD’s “Purchase Orders” are clearly no substitute for enforceable contracts, the expiration of the current Purchase Orders in December 2012 provides the board with another opportunity to address the deficiencies in the current financial structure and rate model. The Water Authority recommends that a board process be established as soon as possible to grapple with these issues. The Water Authority remains willing to execute a take-or-pay contract with MWD, and, to make the other tough decisions that are necessary in order to stabilize MWD’s revenues and fiscal sustainability.

MWD’s rising rates and debt burden, coupled with the lack of political will on the part of the MWD board to require its member agencies to commit to pay for MWD spending programs, is exactly the kind of political risk that was identified in the recent downgrade of our country’s credit rating by Standard & Poors. In May of this year, the rating agencies noted that while MWD is heavily dependent upon variable sales of water for its revenues, its member agencies are not obligated to purchase any water from MWD, a finding that appeared to be a factor in Fitch Ratings’ downgrade. We would like to work together with MWD staff and the rest of the board to avoid further downgrades of MWD’s credit ratings.

Finally, the Water Authority requests that you correct the record regarding the statements made by you at the July 12, 2011 Board meeting discussion on the business plan. This can be accomplished by appending this letter, with attachments, to the July Board meeting minutes, as well as incorporating this letter by reference and attaching it to the minutes of the August 2011 board meeting – and we request that you do so.

Sincerely,

Fern Steiner, on behalf of the Water Authority’s MWD Board Directors

cc: Water Authority Board of Directors
    MWD Board of Directors
    MWD Member Agency Managers
Attachments:

1. Summary of Proposal to Resolve Colorado River and Rate Refinement Issues, dated April 22, 1996
2. Framework of Key Contract Terms, dated February 17, 2000
3. Jeff Kightlinger quote from August 10, 2010 IRP presentation in San Diego
May 6, 2011

Jeff Kightlinger, General Manager
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

Board Memo 5-1 – Sale of Discounted Water

Dear Jeff,

Thank you for responding to our April 25, 2011 letter regarding MWD’s proposed sale of discounted water to selected member agencies. We appreciate that water supply conditions in 2011 have improved significantly; however, the question before the board is what to do with the water that is now available to MWD.

You state in your letter that MWD will maximize the use of its storage assets in 2011 to store available supplies. Director Steiner has requested and you have agreed to provide detailed information how MWD will do that. Past MWD board reports show that MWD has ample storage and put capacity available to store all of the available water in MWD storage facilities. Indeed, by our calculation, even if all of the available water is stored by MWD – as we believe it should be – MWD’s storage will remain less than half full.

You also state that MWD will likely end the year with its regional storage reserves at the “highest levels in history”; however, this observation fails to take into account the fundamental shift in MWD’s water supply reliability planning which – unlike past history – now relies heavily upon the withdrawal of water from storage in dry years. That is why the Water Authority has supported MWD’s multi-billion dollar investment in storage facilities and agreements, which provide more than 5 million acre feet of storage capacity. Given this water supply strategy and investment, it is difficult to understand why MWD now has no intention of maximizing its investment in storage in a year like this, when water is available. MWD is barely out of a multi-year allocation, yet instead of filling its storage reserves, it wants to sell it at a discount.

The problems with the replenishment program have been previously documented and we will not repeat them here. MWD has been well aware of these concerns for many years but has failed to address the problems in any revised board policy or otherwise. Suffice it to say that the program does not provide benefits to MWD commensurate with the cost to MWD of the program. If MWD is intent on selling discounted water, then it should be made available to all MWD member agencies equally, not just to select agencies on the purported basis of a clearly flawed water supply management program.

On the financial side, the board memo and your letter are clear that under the discounted sales...
Mr. Kightlinger  
May 6, 2011  
Page 2

proposal, MWD will not recover its fixed costs. This month’s staff report shows MWD’s FY 2011 sales have further dropped to 1.6 million acre feet (MAF), from the budgeted 1.93 MAF. Although short term cash flow may be improved by the proposed sale of discounted water, it has a deleterious effect on MWD’s financial position overall. We believe you know that MWD’s fiscal crisis is real – we would welcome the opportunity to work with you on finding real solutions.

Regarding your comments on the member agencies’ willingness to pay for current and future fixed costs, our comments were taken directly from the MWD board memo citing the member agencies’ “budgetary and fiscal constraints” as the reason they are not buying MWD water now at the full price that was assumed in the current fiscal year budget. Clearly, the sale of water at full price would be the preferred option because the region would achieve the same storage and water supply benefits and MWD would come closer to hitting its own budget, which is more than $150 million short that also threatens to leave reserves precariously low.

Finally, we believe you know that the Water Authority’s litigation has nothing to do with challenging State Water Project costs – the only question is how those costs should be allocated between supply and transportation. The Water Authority expects to remain one of MWD’s largest customers and to pay its fair share of MWD’s costs under its State Water Project supply contract. Indeed, to our knowledge, the Water Authority is the only MWD member agency that has actually offered to enter into a long-term contract with MWD for the purchase of State Water Project water and other supplies and services. With firm contracts, MWD could count on being able to cover its fixed costs, now and in the future. We would be happy to make a presentation to the board on the history of that offer as well as make a proposal for the future. We agree that MWD is in a fiscal crisis and the gimmicks being employed this year – including a “fire sale” of discounted water – will not solve or even address the real problem.

Sincerely,

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

cc:  Jack Foley, MWD Board Chairman
December 9, 2010

Brian Thomas
Assistant General Manager/Chief Financial Officer
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Dear Mr. Thomas:

We reviewed Appendix A of MWD’s Draft Official Statement, distributed to members of the Board of Directors on November 24, 2010 for an upcoming bond sale. We have a number of concerns. A principal concern is that the Draft Statement does not disclose MWD’s present and future reduction in water sales due to a variety of key facts.

2010 Integrated Resources Plan
The recently adopted 2010 IRP articulated a new untested business strategy for MWD that is different than the historical role it has played in importing supplemental water supplies to Southern California. The implementation of this strategy would result in an overdevelopment of supplies by at least 200,000 acre-feet in 2020 and as much as 500,000 acre-feet per year through the overdevelopment of local supplies – either by MWD directly, or developed in concert with MWD subsidies. This new strategy has significant cost implications that have not been adequately described in the IRP or disclosed in the Draft Official Statement and could result in reduced sales rather than increased sales by MWD in the future. We described our concerns in our October 11, 2010 letter to MWD (copy attached and incorporated herein by reference). The 2010 IRP showed an MWD demand ranging from 1.67 million acre-feet to 1.75 million acre-feet in 2015, depending on how aggressively MWD would pursue local resources development. MWD demand is projected to be even lower in 2035 at between 1.35 million acre-feet and 1.65 million acre-feet. These are significant projected reductions in MWD sales. The Draft Statement fails to adequately disclose this fact.

Moreover, a month after MWD’s board adopted the 2010 IRP, MWD staff released new water sales projections as part of its Long Range Finance Plan that show even lower potential sales by 2020, in a range from a low of 1 million acre-feet, a high of 2
million acre-feet and a “projected expected” sales of 1.6 million acre-feet. The financial impact on MWD of 400,000 to 500,000 acre-feet of lower sales represented by the “projected expected” forecast is significant, and MWD must reconcile this major discrepancy in its Appendix A.

In addition to these concerns, MWD must analyze and disclose applicable limitations on its ability to fund local projects anticipated by the IRP under its existing rate structure, and, subject to the new Constitutional limitations under Proposition 26 as recently passed by California voters.

Projected Water Sales
The projected sales for the near term are overstated given current and reasonably anticipated water sales. After a series of steep rate hikes (increasing Tier 1 Treated Rate by 55 percent between 2008 and 2012), water management actions including aggressive conservation messaging, cessation of discounted replenishment water sales, phasing out of the agricultural program rate, and the implementation of M&I water allocation, MWD has significantly lowered its water demand. For the 10-year period of 2000-2009, MWD’s annual water sales averaged 2.17 million acre-feet. This calendar year, MWD’s sales are projected to equal a multi-decade low of about 1.5 million acre-feet – nearly 700,000 acre-feet below past decade’s average (and 1 million acre-feet below its peak sales year) and importantly, 250,000 acre-feet below MWD’s budgeted amount. Staff reported just last month that MWD’s current year revenue is expected to be $120 million less than budgeted due to declining sales. This will put ever-increasing pressure to raise rates even higher, if not in CY 2012, then in following years.

We do not believe it is reasonable to assume MWD water sales will return to the 2 million acre-feet level in the time frame noted in the Official Statement, or, that it has the water supplies available to sustain sales in this range continuously. Moreover, as noted above, the implementation of the IRP could actually result in further reduction in MWD’s own water sales.

Use of Bond Proceeds and Need for Funds
Given today’s extraordinary upward rate pressure, and downward water sales trends, it is unclear why MWD is considering selling bonds at this time. We were informed by staff just last month due to lower water sales, MWD would be drawing down about $100 million from its Rate Stabilization Fund to help cover the impacts of low sales, resulting in reserves that are lower than the Board’s established minimum level. We should be reviewing all expenditures, including scrubbing the Capital Investment Program, to reduce rate pressure. Selling the bonds now would result in MWD needing to expend the money within the specified time – that does not make sense. MWD needs to first figure
out what its new CIP expenditures should be in the current fiscal situation, and sustained lower water sales before committing itself to spending additional funds.

In conclusion, we believe MWD’s exposure to sustained lower water sales is significant due to factors such as challenges to MWD’s supplies, implementation of SBX7-7, the adoption of the 2010 IRP, and high water rates’ impact on consumer demand; these factors must be disclosed in detail. As such, we request that the Draft Statement be modified to ensure MWD provides adequate disclosure to potential investors.

Thank you.

Sincerely,

Keith Lewinger
Director

Attachment

Cc: MWD Board of Directors
    Jeff Kightlinger, General Manager
    MWD Member Agency Managers
September 22, 2010

Brian Thomas
Assistant General Manager/Chief Financial Officer
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Dear Brian:

On the afternoon of September 16, you distributed to members of the Board of Directors Appendix A of MWD’s Draft Official Statement for an upcoming refunding bond sale and asked for comments to be submitted by noon today; given the tight deadline, we limit our comments in this letter and the attachments to only the most significant issues and concerns with Appendix A. These comments are presented to you by the four of us as directors representing the San Diego County Water Authority. We request that you respond to the questions presented in this letter and make the necessary modifications to Appendix A of the Official Statement before it is finalized and issued. We believe additional time is warranted to schedule a full board review of the issues noted in this letter and in our IRP Comment Letter discussed below.

2010 Integrated Resources Plan

On page A-3, fourth paragraph, MWD makes only passing reference – and does not disclose key facts – about its 2010 Integrated Resources Plan Update. The document states that the IRP “...is expected to be completed in late 2010.” In fact, the IRP is expected to be presented by MWD staff to the Board of Directors for adoption at its October 12, 2010 meeting – only 13 days after the initiation of bond sales covered by this Official Statement. Appendix A fails to disclose material facts about the 2010 IRP that should be disclosed to potential investors, including but not limited to MWD’s plan to develop so-called “buffer” water supplies in the amount of up to 500,000 acre-feet per year, at a cost of billions of dollars over the next 25 years. On September 10, 2010, the Water Authority submitted to MWD extensive comments on the IRP. A copy of that letter is attached and the questions and comments incorporated herein (IRP Comment Letter). We request that MWD provide a substantive discussion in Appendix A regarding potential legal and financial implications from the shift from MWD’s historic role as a supplemental imported water supplier to local water supply developer; that identifies the breadth of the IRP implementation strategies under consideration, and the extent of costs and future water rates that would be necessary to implement the IRP recommendation. Appendix A should also include a discussion – here and elsewhere – on the effects higher water rates are expected to have on MWD sales.

Experience over the past several years clearly shows a nexus between sharply higher water...
rates and conservation (demand reduction) by customers (ratepayers). MWD should disclose the impacts of its IRP strategies that would lead to water rates exceeding $2,000 an acre-foot by 2035 if not sooner and the impacts increasing water rates would have on water demands on MWD. Further, as discussed at length in the IRP Comment Letter, how will MWD ensure that there will be customers to pay for its regional local water supply projects when so many agencies are in the process of developing local water supply projects of their own for which their retail customers will pay through retail water rates. This concern should also be discussed in connection with the renewal of purchase orders at page A-1.

We are also concerned that the discussion is misleading about the purpose and importance of the IRP in the development and implementation of the “Preferred Resource Mix.” Responding to questions about the necessity of CEQA review prior to adoption of the draft IRP update, MWD staff has stated that such review is not required because the IRP is not a document that controls future decision-making in a manner that could result in the possibility of a significant effect on the environment. However, MWD staff has also stated that it intends to take immediate action to implement projects and programs identified in the draft IRP should it be adopted by the Board. When viewed in its entirety, the discussion of the IRP and the Preferred Resource Mix suggest the IRP is viewed by MWD as a controlling document that would be the first step in the implementation of a major new supply program and would be subject to CEQA. If this is not the case, MWD must make that clear and should also provide assurance that CEQA compliance will be accomplished before any actions are taken to implement any of the programs or projects contemplated as part of the draft IRP’s Supply Buffer.

Seawater Desalination Project Subsidies

On page A-4 and again on page A-31, under Seawater Desalination, MWD mischaracterizes the Carlsbad seawater desalination project and the status of the incentive payment agreement with MWD relating to this project. MWD also fails to disclose the fact that MWD has initiated termination proceedings on incentive funding agreements with the Water Authority and its member agencies, and, that it is MWD that has refused to sign the Carlsbad Seawater Desalination Project agreement approved by its own board on November 10, 2009.

In the Seawater Desalination Sections of Appendix A on Pages A-4 and A-31, Metropolitan addresses the status of member agency agreements for incentive funding for seawater desalination projects, including the Water Authority’s incentive funding agreement. Metropolitan states that “SDCWA has not executed the proposed agreement.” This statement would mislead the reader to conclude that but for SDCWA’s execution, the agreement would be in effect today. That is not true. The Water Authority’s incentive funding agreement, approved by the Metropolitan Board on November 10, 2009 and by the Water Authority Board on December 17, 2009, includes rate structure integrity language that allows Metropolitan to terminate the agreement should the Water Authority file litigation to challenge Metropolitan’s rate structure. Following the Water Authority’s initiation of litigation in June 2010 (briefly discussed on page A-47) challenging Metropolitan’s rates and charges, Metropolitan’s Board initiated termination of existing Water Authority funding agreements that include rate structure integrity language. On August 25, 2010, in a letter to the Water Authority from Metropolitan’s General Manager (attached), the Water Authority was notified that “Metropolitan’s Board of Directors also directed staff to defer execution” of the Water Authority’s seawater desalination incentive funding agreement “…as termination proceedings would begin
immediately upon execution.” These facts regarding the Carlsbad Seawater Desalination Project agreement should be stated on pages A-4 and A-31.

**Near-Term Delta Actions**

On page A-25, under *Near-Term Delta Actions*, MWD discusses the potential supply benefit of the proposed Two-Gate System and other “near-term” actions to improve water supply and ecosystem of the Delta. However, MWD does not provide a timeline estimate of when it expects the Two-Gate project to be in place and producing improved supply reliability of approximately 150,000 acre-feet per year in certain years. We request an estimated operational date for the Two-Gate project be added to this discussion.

**Five-Year Supply Plan**

On page A-26, under *Local Resources*, MWD projects that 122,000 of additional, new supply could be online by 2014 from recycled water treatment plants, groundwater recovery plants, desalination plants and new hookups to existing recycled water plants. This figure seems optimistic based on the experience. If MWD indeed projects this level of implementation, it is not our belief that the costs associated with such level of local resources development have been included in the budget or water rates adopted for 2011 or 2012. We request that the estimated costs and associated water rate increases be added to this discussion. In addition, given the long lead time generally associated with the development of such projects, we believe MWD should describe the process by which it will be able to implement local projects of this magnitude within the timeline described in the O.S.

**Significant Exposure to Reduced Sales**

On page A-29, Appendix A describes a construction project that will provide an interconnection between the Antelope Valley-East Kern Water Agency and the Los Angeles Aqueduct. Under an agreement with MWD, the City of Los Angeles will be able to acquire and move into the LA Aqueduct supplies obtained independently of MWD. This section notes that the annual quantity of supplies moving into the LA Aqueduct through the interconnection is “…not to exceed the supplies lost to the City as a result of its Eastern Sierra environmental obligations, including water for the Lower Owens River Project and Owens Lake Dust Mitigation Project….” That amount, Appendix A notes, was 98,000 acre-feet from April 2009 to March 2010. However, MWD does not disclose that the City of Los Angeles currently purchases water used to offset the use of its own Eastern Sierra supplies for environmental purposes from MWD, and that the interconnection with AVEK will allow LA to reduce its purchase from MWD on an acre-foot-for-acre-foot basis. Reduction of sales by approximately 100,000 acre-feet per year will have a material effect on MWD revenues and on MWD’s water rates. And yet, on page A-30, MWD asserts that the City of LA’s “future reliance on Metropolitan supplies may increase with implementation of these (Eastern Sierra environmental) projects.” The motivation for LA to pursue the interconnection with AVEK in the first place is its apparent belief that it can acquire independent supplies at a lower cost than MWD’s supply cost. Therefore, in contrast to the statement on page A-30, it is more likely LADWP will acquire any additional environmental offset water needed from sources other than MWD.

**Future Water Sales and Receipts**

On Page A-69, and again at A-71 to A-72, MWD projects steady growth in water sales over the next five years from 1.77 million acre-feet in the current fiscal year (2011), to 2.11 million acre-feet in FY 2015, “…reflecting a return to average weather conditions.” This projection appears to attribute the current low water demands on MWD (and reduced sales) to a single factor: weather. A return to
normal weather, the report implies, will result in returning sales to pre-shortage levels. No discussion or consideration is provided to what effect other factors – most notably higher water rates – have had, and continue to have in suppressing water demand and sales. The O.S. also fails to discuss or take into account the recently passed 20x2020 legislation requiring 20% conservation at the retail level. Appendix A should provide an analysis of the impacts higher water rates and conservation requirements are having on demand and sales, and factor those impacts into projections of future water sales (e.g. the next five fiscal years and beyond).

Page A-72 notes that because of lower-than-budgeted water sales in the current year (160,000 acre-feet lower than budgeted), MWD will make a draw of $34 million from its Water Rate Stabilization Fund. However, on September 17, 2010, at the MWD Member Agency Managers meeting, MWD management reported that the net draw from the Water Rate Stabilization Fund this year is projected to be $100 million. MWD should reconcile these two figures and ensure the number reflected in Appendix A is the correct one.

We believe the comments contained in this letter and the attachments must be addressed through substantive modifications to Appendix A and request those changes be made to ensure MWD provide accurate and adequate disclosure to potential investors.

Thank you.

Sincerely,

Lynne Heidel
Director

Keith Lewinger
Director

Bud Pocklington
Director

Fern Steiner
Director

Attachments

Cc: MWD Board of Directors
    Jeff Kightlinger, General Manager
Office of the General Manager

October 30, 2012

Director Lynne Heidel
Director Keith Lewinger
Director Fern Steiner
Director Doug Wilson
San Diego County Water Authority
4766 Overland Avenue
San Diego, CA 92123

Dear Directors:

Your letter dated October 8, 2012, regarding Board Letter 8-3—Approve the form of the amended and restated Purchase Order and authorize amendment of Section 4122 of the Administrative Code

Chairman Foley asked me to respond to your letter regarding the form of amended and restated Purchase Order approved by the Board on October 9, 2012.

Your letter contains detailed comments and concerns, most of which were addressed in the staff presentation at the Finance and Insurance Committee on October 8, 2012, and the committee discussion. We will not address them again here. The purpose of this response is to correct your assertion that the Board’s action on November 8, 2011, approving the City of Compton’s request to withdraw its purchase order, is a new policy that should be included in the amended purchase orders.

The November 2011 board letter explained Compton’s reduced water purchase trend due to operational changes that occurred after execution of its purchase order. Upon withdrawal of the purchase order, Metropolitan revised Compton’s Tier 1 limit and will require Compton to pay the Tier 2 Supply Rate on any future water purchases over the revised lower limit.

The Board’s action last November approved only the Compton purchase order withdrawal. If other member agencies make similar requests, they must meet the same conditions, but the Board would consider similar requests from other member agencies individually. This is required under
SDCWA Directors  
October 30, 2012  
Page 2

Administrative Code Section 4404(b) and consistent with the November 2011 board letter. Thus it is not accurate to characterize the November action as a generally-applicable board policy or appropriate to include it in the amended and restated purchase orders.

Sincerely,

[Signature]
Gary Breaux  
Assistant General Manager/Chief Financial Officer

cc: MWD Board of Directors  
SDCWA Board of Directors
Extension of Purchase Orders

Finance & Insurance Committee
Item 8-3
October 8, 2012
Purchase Order Extension

Two-year extension

• To December 31, 2014
• Amendment retains existing terms and conditions
• PO Commitment adjusted to 12 years instead of 10 years
• PO Commitment based on Initial Base Firm Demand as calculated in 2002; no changes to this calculation
• Housekeeping for definitions

Calendar Year 2013 Tier 1 limits incorporate maximum adjustment for the IAWP phase-out

• Consistent with the October 2008 Board Action
Purchase Order Extension Applicability

- 3 member agencies without Purchase Orders cannot now execute Purchase Orders
- 23 member agencies with existing Purchase Orders may choose to execute the Purchase Order Extension
Purchase Order Extension Impacts

- Establishes a member agency’s annual Tier 1 limit
- Retains Tier 2 price signal
  - Provides an incentive to invest in conservation and local projects
- As of the August 2012 invoicing, 19 of the 23 member agencies with Purchase Orders have met the twelve-year Purchase Order Commitment resulting from the extension
  - Burbank, Glendale, Central Basin Municipal Water District, and San Diego County Water Authority have not yet met the additional commitment
Administrative Code Change

Amend section 4122. Base Firm Demand; Initial Base Firm Demand

Incorporate the impact of the phase-out of the Interim Agricultural Water Program (IAWP) on the calculation of the Base Firm Demand effective January 1, 2013

- Recalculation of the Initial Base Firm Demand to account for IAWP sales during FYs 1990-2002
- Calculation of the ten-year rolling average is unchanged
Board Options

Option #1 – Adopt CEQA determination and

- Approve the Amended and Restated Purchase Order to provide a two-year extension of existing member agency Purchase Orders
- Authorize the General Manager to execute the Amended and Restated Purchase Order with member agencies opting to extend their Purchase Orders; and
- Authorize amendment of section 4122 of the Administrative Code

Option #2 –

- Do not approve the Amended and Restated Purchase Order or Administrative Code changes
Staff Recommendation

- Option # 1
Skillman (17:37): Thank you Vice Chair Barbre. Giving myself a minute here to get set-up.

Item 8-3 is the extension of the purchase orders. We came to the committee last month and discussed a request by the member agencies for an extension of the purchase orders. We had been talking to the member agencies and been bringing back to the board a proposal where we would align our rate structure and water management objectives. And we did receive feedback from the member agencies that they didn’t believe that they had enough time to review that proposal and discuss it with their sub-agencies to understand the impacts and requested that we consider an extension of the purchase orders to give them additional time while we talked about this proposal.

So, what we have before you is an extension of the purchase order. It is a two year extension. The purchase orders would extend to December 31, 2014; they’re currently set to expire December 31, 2012, this year. The amendment retains the existing terms and conditions of the Purchase Order. The Purchase Order commitment itself is adjusted to 12 years instead of 10 years. The calculation of the Purchase Order commitment is still based on the initial base firm demand as it was calculated in 2002; there’s no change to that calculation. All we’ve done is we’ve take that calculation times 60 percent times 12 years instead of 10 years to determine the commitment for the agencies who want to sign it for the extension.

We do have some house-keeping for definitions; I’ll be going over those. So, why don’t we do that right now? There was a question about why we didn’t address this as a letter amendment to the Purchase Order instead of developing an Amended and Restated Purchase Order. And in your packet, Attachment 1 is a clean-line version of the Amended and Restated Purchase Order. And in your packet, Attachment 1 is a clean-line version of the Amended and Restated Purchase Order. Attachment 2 is a red-line version. And as we were working through it, what we found is that there were a number of issues that we needed to clarify and clean-up. And as we tried to work through that as a letter agreement it actually became quite complicated because we had to make a reference back to each particular item that we were referring to. So it became actually very difficult to follow the later agreement and we found it was easier just to do a red-line version of the Purchase Order itself.

One of the things we did find some discrepancies in terms that were used in the Purchase Orders it was originally constructed and we’ve clarified those. So in a number of places we had the phrase “base demand” and we’ve changed that to be “base firm demand” which is consistent with the Administrative Code. Also the Purchase Order was, as it was constructed reflected Metropolitan’s world as it existed in 2002 and at that time we had Firm water, Interim Agricultural Water Program water and Long-Term Seasonal Storage water. Since that time we’ve actually developed a number of water programs and the language in the Purchase Order didn’t really contemplate those changes. So in a number of places we had a phrase that said “excluding deliveries of system water made under the Interim Agricultural Water Program and the Long-Term Seasonal Storage Service.” We added the phrase “including, but not limited to,” and the reason we did that is so we can incorporate changes as we make them. And as an example of some of the things that we’ve done since 2002, the Long-Term Seasonal Storage Service Program became the Replenishment Service Program; we implemented the surface storage operating agreement,
the recharge and recovery operating agreement, supplemental storage program, water supply allocation plan, Storage Program, and Conjunctive Use Program. And so we’ve added the phrase “including, but not limited to” so we can give ourselves the flexibility of developing programs not only what we’ve done in the last ten years, but we might do in the next two years. So that really is the change to the Purchase Order itself.

We’ve also cleaned-up some of the definitions and this gets to the second item. In the original Purchase Order, member agencies’ based firm demand, which determined their Tier 1 limit was, went back to the initial based firm demand or a ten-year rolling average. In October of 2008, the Board took action to eliminate and phase-out the Interim Agricultural Water Program. Effective January of 2013 those member agencies who were actively participating in the IAWP Program will have their Tier 1 limits changed to incorporate the full phase-out and the adjustment to their Tier 1 limits. So the concept of initial base firm demand post-IAWP is important to be reflected in the Purchase Order separate and distinct from initial base firm demand because they’re being used in two different ways.

In terms of the applicability of the Purchase Order extension, as you will recall we have three member agencies who do not have executed Purchase Orders; at this point in time they cannot execute a Purchase Order. The remaining 23 member agencies with existing Purchase Orders may choose to execute the Purchase Order extension but do not have to, depends on your individual circumstances. Why this is important and the impacts to the member agencies, you’ll remember that the Purchase Orders expires December 31 of this year. And absent an action by the Board every member agencies’ Tier 1 limit would revert to 60 percent of their initial base firm demand post-IAWP. So the Purchase Order extension is important because it establishes a member agency’s annual Tier 1 limit. If you execute the Purchase Order it’s gonna be 90 percent of your base firm demand. If you don’t execute the Purchase Order it will be 60 percent of your base firm demand effective for Calendar Year 2013. It continues to retain the Tier 2 price signal. And the Board has told us that that Tier 2 price signal is important because it provides an incentive to invest in conservation and local projects. As of the August 2012 invoicing, 19 of the 23 member agencies with Purchase Orders have met the 12 year Purchase Order commitment that results from the extension. The agencies that have not met that are Glendale, Burbank, Central Basin Municipal Water District, and the San Diego County Water Authority.

We are proposing an Administrative Code change and hopefully I touched on why that’s important. For purposes of calculating the Purchase Order commitment we’re using the original initial base firm demand concept as it was included in the Purchase Orders and defined in 2002. However, for calculating a member agency’s base firm demand for 2013, we need to use the initial base firm demand post-IAWP so we’ve included in the Administrative Code a description of how we’re calculating that and what it means. And importantly, the calculation of the 10-year rolling average is unchanged by all of this; it is still the 10-year rolling average of firm demands for a 10-year period.

And so the Board options that we have is Option 1 is to adopt the CEQA determination and approve the Amended and Restated Purchase Order, to provide a two-year extension of existing member agency Purchase Orders; authorize the General Manager to execute the Amended and Restated Purchase Order with member agencies opting to extend their Purchase Orders; and authorize amendment of section 4122 of the Administrative Code.

Option 2 is not to approve the amended and restated Purchase Order. And that, staff’s recommendation is Option 1. If there are questions...
Barbre: OK. Thank you. I’ll entertain a motion on that. To move which Option? Option 1? It’s been moved, seconded. Any comments, any questions? Director Wilson.

Wilson: Thank you Mr. Chair. As you mentioned earlier, the County Water Authority delegates have submitted a letter on this item earlier this morning. And while we, we can, we’re prepared to recommend approval of the actual commitment to our Board of Directors; we cannot agree to the execution of the new terms and conditions. We would’ve preferred to have a more simple approach with just the extension of the commitments. We didn’t see a need to change all those terms and conditions. So with that, you know, I’ll be voting no on behalf of the delegates. And we would ask this be part of the Administrative Record.

Barbre: Ok dually noted. Any other comments, questions? Ok any opposition? We have one opposition, any others? Ok the motion carries with one opposition. Thank you very much.
November 21, 2012

Attention: Imported Water Committee

Metropolitan Water District’s Purchase Order History. (Information)

Purpose
This report presents Metropolitan Water District’s Purchase Order history and gives the board background to provide staff direction on the extension of purchase order.

Background
In March 2002, MWD adopted a new rate structure. At that time, it also created a “Purchase Order,” the stated objective of which was to secure financial commitment for MWD. Member agencies executing a Purchase Order would be allowed to purchase a greater volume of water at MWD’s more favorable Tier 1 water rate. The Purchase Order was for a 10-year period ending on December 31, 2012. At its June 2002 meeting, the Water Authority Board approved execution of a Purchase Order with MWD.

Under the existing Purchase Order, an “Initial BaseDemand” equal to the MWD member agency’s highest annual “FirmDemand” in any fiscal year during the period 1989/90 through 2001/02 was calculated for each agency. The Base Demand was defined as greater of (i) the Initial Base Demand or (ii) the ten-year rolling average of the agency’s “Firm Demand.” “Firm Demand” was in turn defined as purchases of “non-surplus “System Water” supplies, including full service and seasonal shift deliveries. “System Water” was described as, “water supplies developed by Metropolitan and delivered to the Purchaser through the System or other means.”

As calculated under the Purchase Order, the Water Authority agreed that it would purchase at least 60 percent of its Initial Base Demand multiplied by 10 over the 10-year period expiring December 31, 2012. Agencies that executed Purchase Orders could purchase up to 90 percent of the Base at the Tier 1 rate, while agencies that did not execute Purchase Orders could purchase only up to 60 percent of the Base at the Tier 1 rate. Any agency that executed a Purchase Order and purchased less water from MWD than specified in the Purchase Order would be required to pay MWD the difference between the Purchase Order and actual purchases, multiplied by the average of the Tier 1 supply rate in effect during the term of the Purchase Order. In this event, the member agency would only be required to pay the supply rate, and is not obligated to pay any other rates and charges, including the System Access Rate, System Power Rate or Water Stewardship Rate.

Because a member agency has 10 years to purchase the total volume of water stated in the Purchase Order, and because MWD does not allocate the entire cost of water on its supply rate (a central point in the Water Authority’s pending rate litigation with MWD), the Purchase Order never achieved its stated purpose of providing a significant amount of firm revenues to MWD. In November 2011, the MWD board voted to allow the City of Compton to terminate its Purchase Order in exchange for payment of a $5,000 administrative fee. The MWD Board Memo dated November 8, 2011 stated that, “If other member agencies request to withdraw their Purchase
Order commitment, the same conditions for Tier 1 and Tier 2 payments and the administrative withdrawal fee would apply.”

Of MWD’s 26 member agencies, 24 executed a Purchase Order – all except San Marino and San Fernando. With the City of Compton terminating its Purchase Order last November as noted above, currently 23 of the member agencies have a Purchase Order with MWD.

Discussion
MWD has historically used its Long Range Finance Plan (LRFP) process to assess and update its financial policies, water rates and long-term planning projections. However, its current LRFP – adopted by the board in 2004 – has not been updated. Over these past eight years, there have been substantial changed circumstances that are not accounted for in MWD’s core water supply and financial planning documents.

MWD staff began a process to update the LRFP in 2007, working with the member agency managers and providing occasional PowerPoint presentations to the MWD board of directors. The Water Authority delegates have repeatedly requested and strongly urged both MWD management and the MWD board of directors to review and address key water supply and financial planning issues. It has been clear for a very long time, for example, that MWD’s water sales have been substantially less than forecasted and its water rates have far exceeded those projected in its 2004 LRFP.

The 2007 process was titled by MWD staff as the, “Long Range Finance Plan —Rate Structure” process. One of the early key objectives was to develop a strategy to address the fact that MWD’s fixed costs far exceed its fixed revenues, and, to plan for the expiration of the Purchase Orders in 2012. An important objective for the Water Authority in this discussion was for MWD to better align recovery of its fixed costs with the agencies that benefit from the costs being incurred to provide standby or “peaking” capacity. This process went forward in fits and starts over the past eight years. However, it became increasingly clear that MWD’s member agency managers are far more interested in shifting financial risks to MWD and securing subsidies and discounted water from MWD than they are in having their agencies make firm commitments to pay MWD’s current or future costs.

In June of this year, MWD reconvened the member agency managers but eliminated any reference to developing an updated LRFP. (For more information on the LRFP process, see September's board information item titled, “Metropolitan Water District’s Rate Refinement Discussion.”) MWD’s Assistant General Manager/Chief Financial Officer (“CFO”) has recently stated that MWD no longer needs a LRFP and that he will, instead, be managing long term planning by providing a five-year rate forecast through the biennial budget process. The Water Authority delegates have stated that they do not believe that a five-year look-ahead is sufficient to support the level of investment MWD has described in its Integrated Resources Plan or that would be required to support funding the Bay Delta Conservation Plan project.

The CFO and other MWD staff have expressly acknowledged that MWD’s “Purchase Orders” do not achieve the stated objective of providing MWD increased firm revenues or financial
stability at a meaningful level. However, staff recommended, and the board approved in October “extension” of the Purchase Orders for an additional two years (changing the term from 10-years to 12-years). MWD said that its member agencies told them there had not been enough time to evaluate alternatives, in spite of the fact that rate issues had been under discussion since 2007. MWD has also indicated that it will now, once again, defer any further discussion of financial issues to 2013. The only exception is that ongoing discussions about reinstituting discounted water sales to the member agencies through a new storage program (or, sale of discounted water for replenishment) will continue in the Water Planning and Stewardship Committee.

MWD’s Purchase Order was designed to create the appearance of a “contract” without any meaningful exchange of consideration on the part of either party. Likewise, the 2012 Revised Purchase Order does not represent a meaningful “commitment” of any kind by the member agencies to purchase MWD water – because most of them have already bought more water than required under the 2012 Revised Purchase Order. MWD staff reported in October, of the 23 member agencies that have Purchase Orders with MWD, 19 have already purchased enough water to meet not only their 10-year, but also their revised 12-year “commitment.” Thus, as to these agencies, signing the two-year extension will not obligate them to purchase even acre-foot of water. The Water Authority has already exceeded its 10-year target of 3,342,570.6 AF, and in fact, by October 30 it has purchased 4.028 MAF of firm water from MWD -- enough to reach the new 12-year target.

Even if it does not execute the 2012 Revised Purchase Order, the Water Authority is not at risk of exceeding the Tier 1 annual limit that would apply without a Purchase Order because the limit far exceeds the Water Authority’s projected demand on MWD for 2013 and 2014.

Moreover, MWD’s Purchase Order and 2012 Revised Purchase Order are not based upon, or consistent with the cost of service requirements MWD is legally required to follow in setting its water rates and charges for the services it provides.

Based solely on the Water Authority’s projected demand on MWD, it would be indifferent to signing an extension of the Purchase Order to “commit” to buy water it is already going to buy. However, because MWD staff recommended and the board approved an “Amended and Restated Purchase Order” that contained unexplained changes to the existing terms and conditions, the Water Authority’s delegation objected to these terms. See the Water Authority Delegation’s letter to MWD dated October 8, 2012 (Attachment 1).

The Purchase Order’s relationship to the MWD rate litigation will be discussed in closed session (Committee agenda item IV-2).

Prepared by: Debbie S. Discar-Espe, Senior Water Resources Specialist
Reviewed by: Amy Chen, Director of MWD Program
Approved by: Dennis A. Cushman, Assistant General Manager

Attachment 1: Water Authority Delegation’s letter to MWD re Purchase Order dated October 8, 2012
October 8, 2012

Jack Foley, Chair of Board
and Members of the Board
Metropolitan Water District
P. O. Box 54153
Los Angeles, CA 90065-0153

RE: Board Memo 8-3 – Approve the form of the amended and restated Purchase Order; and authorize amendment of section 4122 of the Administrative Code

Dear Mr. Foley and Board Members,

We have reviewed Board Memo 8-3 including Attachments. We are prepared to recommend to the Water Authority board of directors renewal of the purchase order commitment for two years, to December 31, 2014, “under the existing terms and conditions,” in accordance with the recommendation stated in the “Executive Summary” at page one, paragraph one of the board memo and as reflected in Attachment 3, Page 1 of 1, 2013, Tier 1 Limit and 2003 – 2014 Purchase Order Commitment. However, we are unable to recommend execution of the new form of Purchase Order which contains unexplained changes to the existing terms and conditions.

The “Details” section at page one, paragraph two of the board memo states that the new form of agreement contains amendments to definitions “to align the Purchase Orders with water programs implemented since the 2002 execution of the Purchase Order.” However, there is no explanation provided of the “alignment.” In fact, none of the definitional changes are necessary in order to achieve the stated objective of extending the purchase order for an additional two years under the existing terms and conditions or to “align” the Purchase Order to “new water programs.” The extension of the purchase order commitment could be accomplished simply by amending Section 4122 and the Purchase Order to reflect a “twelve-year” instead of a “ten-year” rolling average of deliveries of water (subject to adding one additional board policy change noted below).

Instead of presenting this simple amendment, however, an “amendment and restatement” of the Purchase Order is proposed. A contract amendment does not replace the whole original contract (just the part that’s changed by the amendment, here, a simple change from ten-years to twelve-years). Only when a contract requires extensive changes is it the common practice to create an entirely new agreement in the form of an “amendment and restatement.”

For example, a number of terms that are not defined in Metropolitan’s Administrative Code or included in its cost of service analysis are used in the new form of Purchase Order (e.g., “non-interruptible System Water supplies,” and “Recharge and Recovery Operating Agreement

A public agency providing a safe and reliable water supply to the San Diego region
water,” among others). The edits to the definitions are unnecessary and whatever the intent, the proposed amendments are inconsistent with the explanation being provided by staff that the Purchase Orders are being extended under the “existing terms and conditions.”

Finally, while staff has included a number of unexplained changes to the form of the Purchase Order, it has left out the only policy change that has actually been adopted by the board of directors. That is that any member agency may withdraw and terminate its Purchase Order commitment upon the payment of a $5,000 administrative withdrawal fee. See November 8, 2011 Board Memorandum 8-3, adopted by the board on the same date. This provision should be included in the amended Purchase Order commitment.

In closing, we reiterate the concerns expressed in our September 10, 2012 letter to you RE Update on Rate Refinement (Board Information Item 7-b) (copy attached) including the inefficacy of Metropolitan’s Purchase Orders to achieve the objective of securing a revenue stream sufficient to pay Metropolitan’s costs, or, to provide a reasonable basis for the planning and provision of long term capital facilities and water supply programs. Metropolitan’s staff has acknowledged that Purchase Orders do not achieve these objectives, and yet, these critical financial decisions are being deferred for another two years. We are troubled by the continued spending patterns and practices at Metropolitan which do not provide sufficient fixed revenues at the same time the member agencies and board members are unable to agree how these fixed costs will be paid for over the long term. The trend and signals that we see are that Metropolitan’s member agencies intend to purchase less, not more water from Metropolitan. The continued spending could result in substantial stranded costs as well as massive rate hikes that would be necessary to pay for these programs with a declining sales base.

We assume other agencies will be required to obtain the approval of their governing boards. Our recommendations to the Water Authority’s board of directors will be as described in this letter.

Sincerely,

Keith Lewinger
Director

Fern Steiner
Director

Doug Wilson
Director

cc: San Diego County Water Authority Board of Directors
Office of the General Counsel

January 4, 2013

Daniel S. Hentschke, Esq.
General Counsel
San Diego County Water Authority
4677 Overland Avenue
San Diego, CA 92123

Dear Mr. Hentschke:

Re: Amended and Restated Purchase Order for System Water to be Provided by the Metropolitan Water District of Southern California

Thank you for your December 27, 2012 letter to Gary Breaux. Your letter (enclosed for reference) states that the San Diego County Water Authority (SDCWA) Board of Directors authorized its General Manager to sign the “Amended and Restated Purchase Order for System Water to be Provided by the Metropolitan Water District of Southern California” under protest and with a full reservation of rights based on your claims that execution of the agreement is an act of form over substance and that the agreement is illusory, lacks consideration, contains false recitals, does not represent a mutual agreement, and is illegal.

Metropolitan disagrees completely with each and every one of your statements. As you know, mutual consent and the intent to be legally bound is necessary for contract formation, and it is clear by your statements, SDCWA’s failure to timely provide executed originals for execution by Metropolitan, and your failure, as agency counsel, to approve the agreement as to form and content, that SDCWA does not intend to recognize the validity of, or to be bound by, this purely voluntary agreement. Metropolitan cannot execute the Amended and Restated Purchase Order under these circumstances. The existing rate structure, including Tier 1 limits for member agencies that have declined to enter into voluntary purchase orders, will therefore govern continuing water service to the SDCWA.

Very truly yours,

Marcia Scully
General Counsel

Enclosure

cc: G. Breaux
Metropolitan Water District of Southern California Board of Directors
San Diego County Water Authority Board of Directors
**Finance and Insurance Committee**

Meeting with Board of Directors*

**February 11, 2013**

9:00 a.m. -- Room 2-145

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**Meeting Schedule**

<table>
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<tr>
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1. **Opportunity for members of the public to address the committee on matters within the committee's jurisdiction** (As required by Gov. Code Section 54954.3(a))

2. **Approval of the Minutes of the meeting of the Finance and Insurance Committee held January 7, 2013**

3. **MANAGEMENT REPORTS**
   a. Report on investment activity
   b. Financial highlights

4. **CONSENT CALENDAR ITEMS — ACTION**
   None

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Date of Notice: January 30, 2013
5. OTHER BOARD ITEMS — ACTION

8-1 Authorize the execution and distribution of Official Statements in connection with the issuance of the Water Revenue Refunding Bonds, 2013 Series A, 2013 Series B, and 2013 Series C, and amendment and termination of interest rate swaps. (F&I)

6. BOARD INFORMATION ITEMS

None

7. COMMITTEE ITEMS

None

8. FOLLOW-UP ITEMS

None

9. FUTURE AGENDA ITEMS

10. ADJOURNMENT

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**Water Planning and Stewardship Committee**

Meeting with Board of Directors*

**February 11, 2013**

9:30 a.m. – Room 2-456

<table>
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1. **Opportunity for members of the public to address the committee on matters within the committee’s jurisdiction** (As required by Gov. Code Section 54954.3(a))

2. **Approval of the Minutes of the meeting of the Water Planning and Stewardship Committee held January 7, 2013**

3. **CONSENT CALENDAR ITEMS — ACTION**

   **7-4** Authorize entering into a Local Resources Program agreement with Calleguas Municipal Water District and Camrosa Water District for the Round Mountain Water Treatment Plant. (WP&S)

   **7-5** Adopt resolutions to (1) support applications, and (2) authorize General Manager to accept funding and enter into contracts with Bureau of Reclamation for WaterSMART grant funding if awarded. (WP&S)
4. OTHER BOARD ITEMS — ACTION

None

5. BOARD INFORMATION ITEMS

None

6. COMMITTEE ITEMS

a. Oral report on Water Surplus and Drought Management

7. MANAGEMENT REPORTS

a. Bay-Delta Matters
b. Colorado River Matters
c. Water Resource Management Manager's report

8. FOLLOW-UP ITEMS

None

9. FUTURE AGENDA ITEMS

10. ADJOURNMENT

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Date of Notice: January 30, 2013
E&O Committee
T. Evans, Chair
G. Brown, V. Chair
T. Babcock
B. Barbre
M. Camacho
D. De Jesus
A. Grunfeld
E. Little
S. Lowenthal
J. Morris
G. Peterson
R. Record
D. Sanchez
F. Steiner
B. Wright

Engineering and Operations Committee
Meeting with Board of Directors*
February 11, 2013
10:30 a.m. -- Room 2-145

Monday, February 11, 2013
Meeting Schedule

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

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1. **Opportunity for members of the public to address the committee on matters within the committee's jurisdiction** (As required by Gov. Code Section 54954.3(a))

2. **Approval of the Minutes of the meeting of the Engineering and Operations Committee held January 7, 2013**

3. **CONSENT CALENDAR ITEMS — ACTION**

   **7-6** Appropriate $1.58 million; and authorize final design of enhanced bromate control systems for the Henry J. Mills and F E. Weymouth Water Treatment Plants (Approp. 15472). (E&O)

   **7-7** Appropriate $920,000; and award $490,292.26 contract to Global Power Group, Inc., to replace the data center Uninterruptible Power Supply at Metropolitan’s Headquarters Building (Approp. 15376). (E&O)
7-8 Appropriate $225,000; and authorize final design of upgrades to the sodium hypochlorite feed system at Palos Verdes Reservoir (Approp. 15441).  (E&O)

4. OTHER BOARD ITEMS — ACTION

8-2 Appropriate $4.78 million; and authorize (1) preliminary design to rehabilitate treatment basins at the F. E. Weymouth Water Treatment Plant; and (2) final design to rehabilitate treatment basins at the Robert B. Diemer Water Treatment Plant (Approps.15440 and 15380).  (E&O)

8-3 Appropriate $3.2 million; and authorize (1) completion activities for the Diemer Oxidation Retrofit Program; (2) final design and permitting for revegetation of slopes at the Robert B. Diemer Water Treatment Plant; and (3) agreement with Helix Environmental Planning, Inc. in an amount not to exceed $310,000 (Approp. 15389).  (E&O)

8-4 Authorize entering into new agreements with Southern California Edison Company for the sale of renewable energy from the Red Mountain and Venice Hydroelectric Power Plants.  (E&O)  (To be mailed separately)

5. BOARD INFORMATION ITEMS

None

6. COMMITTEE ITEMS

None

7. MANAGEMENT REPORTS

a. Water System Operations Manager’s report

b. Engineering Services Manager’s report

8. FOLLOW-UP ITEMS

None
9. FUTURE AGENDA ITEMS

10. ADJOURNMENT

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Organization, Personnel and Technology Committee
Meeting with Board of Directors*

February 11, 2013

12:00 p.m. -- Room 2-456

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

* The Metropolitan Water District’s meeting of the Organization, Personnel and Technology Committee is noticed as a joint committee meeting with the Board of Directors for the purpose of compliance with the Brown Act. Members of the Board who are not assigned to the Organization, Personnel and Technology Committee may participate as members of the Board, whether or not a quorum of the Board is present. In order to preserve the function of the committee as advisory to the Board, members of the Board who are not assigned to the Organization, Personnel and Technology Committee will not vote on matters before the meeting of the Organization, Personnel and Technology Committee.

1. Opportunity for members of the public to address the committee on matters within the committees’ jurisdiction (As required by Gov. Code Section 54954.3(a))

2. Approval of the Minutes of the meeting of the Organization, Personnel and Technology Committee held December 10, 2012

3. CONSENT CALENDAR ITEMS — ACTION

   None

4. OTHER BOARD ITEMS — ACTION

   None
5. BOARD INFORMATION ITEMS

None

6. COMMITTEE ITEMS

a. Update on AFSCME Class/Comp Study

b. Administrative Services Cost Savings Opportunities

7. FOLLOW-UP ITEMS

None

8. FUTURE AGENDA ITEMS

9. ADJOURNMENT

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Audit and Ethics Committee
Meeting with Board of Directors*

February 11, 2013
12:30 p.m. -- Room 2-145

Monday, February 11, 2013
Meeting Schedule

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1. **Opportunity for members of the public to address the committee on matters within the committee's jurisdiction** (As required by Gov. Code Section 54954.3(a))

2. **Approval of the Minutes of the meeting of the Audit and Ethics Committee held October 23, 2012**

3. **CONSENT CALENDAR ITEMS -- ACTION**

   None

4. **COMMITTEE ITEMS**

   a. General Auditor’s summary of activities for the Audit Department

   b. Ethics Officer’s summary of activities for the Ethics Department
5. **ADJOURNMENT**

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Communications and Legislation Committee
Meeting with Board of Directors*

February 12, 2013

10:30 a.m. -- Room 2-456

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

2. Approval of the Minutes of the meeting of the Communications and Legislation Committee held January 8, 2013

3. COMMITTEE CHAIR'S REPORT

4. CONSENT CALENDAR ITEMS — ACTION
   None

5. OTHER BOARD ITEMS — ACTION
   None

Date of Notice: January 30, 2013
6. BOARD INFORMATION ITEMS
   None

7. COMMITTEE ITEMS
   a. Report on activities from Washington, D.C.
   b. Report on activities from Sacramento
   c. Water Bond Update

8. MANAGEMENT REPORT
   a. External Affairs Management report

9. FUTURE AGENDA ITEMS

10. ADJOURNMENT

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Legal and Claims Committee
Meeting with Board of Directors*

February 12, 2013

9:30 a.m. -- Room 2-145

Tuesday, February 12, 2013

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L&C Committee
D. Fleming, Chair
R. Wunderlich, V. Chair
L. Ackerman
S. Ballin
M. Camacho
L. Dick
J. Edwards
D. Griset
V. Mudd
J. Quiñonez
R. Record
F. Steiner

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1. **Opportunity for members of the public to address the committee on matters within the committee’s jurisdiction** (As required by Gov. Code Section 54954.3(a))

2. **Approval of the Minutes of the meeting of the Legal and Claims Committee held January 8, 2013**

3. **CONSENT CALENDAR ITEMS — ACTION**

   None

4. **OTHER BOARD ITEMS — ACTION**

   None

5. **BOARD INFORMATION ITEMS**

   None

Date of Notice: January 30, 2013
6. COMMITTEE ITEMS
   a. General Counsel’s report of monthly activities
   b. Report on Consolidated Delta Smelt Cases, USDC Case No. 1:09-CV-407
      LJO-DLB; and Consolidated Salmonid Cases, USDC Case
      No. 1:09-CV-1053 LJO-DLB.  
      [Conference with legal counsel—existing litigation; to be heard in closed session
      pursuant to Gov. Code Section 54956.9(a)]
   c. Report on San Diego County Water Authority v. Metropolitan Water District
      of Southern California, et al., San Francisco County Superior Court Case
      No. CPF-10-510830 and No. CPF-12-512466.  
      [Conference with legal counsel—existing litigation; to be heard in closed session
      pursuant to Gov. Code Section 54956.9(a)]

7. FOLLOW-UP ITEMS
   None

8. FUTURE AGENDA ITEMS

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of the meeting to ensure availability of the requested service or accommodation.

Date of Notice: January 30, 2013
REVISED AGENDA

Regular Board Meeting

February 12, 2013

11:30 a.m. -- Board Room

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1. Call to Order
   (a) Invocation: Nery Watson, Buyer, Business Technology Group
   (b) Pledge of Allegiance: Vice Chairman John Murray, Jr.

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 January 8, 2013. (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 January

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REVISED: Date of Notice: February 5, 2013
C. Induction of new Director, Michael Touhey, from Upper San Gabriel Valley Municipal Water District
   (a) Receive credentials
   (b) Report on credentials by General Counsel
   (c) File credentials
   (d) Administer Oath of Office
   (e) File Oath

D. Induction of new Director, Robert Apodaca, from Central Basin Municipal Water District
   (a) Receive credentials
   (b) Report on credentials by General Counsel
   (c) File credentials
   (d) Administer Oath of Office
   (e) File Oath

E. Induction of new Director, Leticia Vasquez, from Central Basin Municipal Water District
   (a) Receive credentials
   (b) Report on credentials by General Counsel
   (c) File credentials
   (d) Administer Oath of Office
   (e) File Oath

F. Authorize preparation of Commendatory Resolution for Director Timothy F. Brick, representing city of Pasadena

G. Approve committee assignments

H. Chairman's Monthly Activity Report

6. DEPARTMENT HEADS' REPORTS

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

B. General Counsel's summary of Legal Department activities for the month of January

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

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

REVISED: Date of Notice: February 5, 2013
7. CONSENT CALENDAR ITEMS — ACTION

7-1 Authorize granting of two permanent easements to Southern California Edison on Metropolitan-owned properties in Los Angeles and Orange Counties. (RP&AM)

Recommendation:

Option #1:

Adopt the CEQA determination and authorize the General Manager to grant two permanent easements to Southern California Edison in Los Angeles and Orange Counties.

7-2 Authorize amendment of a long-term license agreement with Desert Sunlight Holdings, LLC on Metropolitan property in Riverside County. (RP&AM)

Recommendation:

Option #1:

Adopt the CEQA determination and authorize the General Manager to amend the current license agreement with Desert Sunlight Holdings, LLC on Metropolitan property in Riverside County.

Tabled by committee 7-3 Affirm the General Manager’s determination that one parcel consisting of 8.426 acres in the unincorporated community of Mentone in San Bernardino County, a portion of Metropolitan Water District of Southern California’s Parcel No. INFED 1-24-150 (APN 0299-111-02), is surplus to Metropolitan’s needs. (RP&AM)

7-4 Authorize entering into a Local Resources Program agreement with Calleguas Municipal Water District and Camrosa Water District for the Round Mountain Water Treatment Plant. (WP&S)

Recommendation:

Option #1:

Adopt the CEQA determination and authorize the General Manager to enter into a Local Resources Program agreement for the Round Mountain Water Treatment Plant with Calleguas and Camrosa for up to 1,000 acre-feet per year of recovered groundwater under terms included in the board letter.

REVISED: Date of Notice: February 5, 2013
7-5 Adopt resolutions to (1) support applications, and (2) authorize General Manager to accept funding and enter into contracts with Bureau of Reclamation for WaterSMART grant funding if awarded. (WP&S)

Recommendation:

Option #1:

Adopt the CEQA determination and the resolutions to support WaterSMART grant applications and authorize the General Manager to accept funding and enter into agreements with Reclamation, if awarded.

7-6 Appropriate $1.58 million; and authorize final design of enhanced bromate control systems for the Henry J. Mills and F E. Weymouth Water Treatment Plants (Approp. 15472). (E&O)

Recommendation:

Option #1:

Adopt the CEQA determination and
a. Appropriate $1.58 million; and
b. Authorize final design of enhanced bromate control systems for the Mills and Weymouth plants.

7-7 Appropriate $920,000; and award $490,292.26 contract to Global Power Group, Inc., to replace the data center Uninterruptible Power Supply at Metropolitan’s Headquarters Building (Approp. 15376). (E&O)

Recommendation:

Option #1:

Adopt the CEQA determination and
a. Appropriate $920,000; and
b. Award $490,292.26 contract to Global Power Group, Inc. to replace the data center Uninterruptible Power Supply at Metropolitan’s Headquarters Building.

7-8 Appropriate $225,000; and authorize final design of upgrades to the sodium hypochlorite feed system at Palos Verdes Reservoir (Approp. 15441). (E&O)
Recommendation:

Option #1:

Adopt the CEQA determination and
a. Appropriate $225,000; and
b. Authorize final design of upgrades to the sodium hypochlorite feed system at Palos Verdes Reservoir.

(END OF CONSENT CALENDAR)

8. OTHER BOARD ITEMS — ACTION

8-1 Authorize the execution and distribution of Official Statements in connection with the issuance of the Water Revenue Refunding Bonds, 2013 Series A, 2013 Series B, and 2013 Series C, and amendment and termination of interest rate swaps. (F&I)

Recommendation:

Option #1:

Adopt the CEQA determination and
a. Approve the draft Official Statements substantially in the form attached to the board letter, with changes approved by the General Manager and General Counsel;
b. Authorize the General Manager, or any designee of the Ad Hoc Committee, to execute the Official Statements;
c. Authorize distribution of the Official Statement in connection with issuance of the bonds; and
d. Authorize the Ad Hoc Committee or its designee to approve and the Chief Financial Officer to execute amendment and termination of interest rate swaps (in whole or in part) related to the subject refunding.

8-2 Appropriate $4.78 million; and authorize (1) preliminary design to rehabilitate treatment basins at the F. E. Weymouth Water Treatment Plant; and (2) final design to rehabilitate treatment basins at the Robert B. Diemer Water Treatment Plant (Approps.15440 and 15380). (E&O)
Recommendation:

Option #1:

Adopt the CEQA determinations and
a.  Appropriate $4.78 million;

Option #1:

Adopt the CEQA determinations and
a.  Appropriate $4.78 million;

8-3  Appropriate $3.2 million; and authorize (1) completion activities for the Diemer Oxidation Retrofit Program; (2) final design and permitting for revegetation of slopes at the Robert B. Diemer Water Treatment Plant; and (3) agreement with Helix Environmental Planning, Inc. in an amount not to exceed $310,000 (Approp. 15389).  (E&O)

Recommendation:

Option #1:

Adopt the CEQA determinations and
a.  Appropriate $3.2 million;

Title change 8-4  Authorize new agreements with the Southern California Edison Company for the sale of renewable energy from the Red Mountain and Venice Hydroelectric Power Plants; and adopt resolution to authorize execution and performance of the agreements.  (E&O)

Recommendation:

Option #1:

Adopt the CEQA determination and
a.  Adopt the resolution attached to the board letter; and

b.  Authorize the General Manager to enter into Renewable Auction Mechanism 3 Pro Forma Renewable Power Purchase and Sale Agreements with Edison under the terms described in the letter, with changes approved by the General Manager and General Counsel, for the sale of renewable output from the Red Mountain and Venice Hydroelectric Power Plants, if the General Manager determines the operational and financial requirements are acceptable.
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.
Summary Report for
The Metropolitan Water District of Southern California
Board Meetings
February 12, 2013

INDUCTION OF NEW DIRECTORS

Director Michael Touhey was inducted to the Board of Directors representing Upper San Gabriel Valley Municipal Water District. (Agenda Item 5C)

Director Robert Apodaca was inducted to the Board of Directors representing Central Basin Municipal Water District. (Agenda Item 5D)

Director Leticia Vasquez was inducted to the Board of Directors representing Central Basin Municipal Water District. (Agenda Item 5E)

COMMITTEE ASSIGNMENTS

Director Touhey was assigned to the Finance and Insurance Committee and Water Planning and Stewardship Committee; Director Apodaca was assigned to the Organization, Personnel and Technology Committee and Communications and Legislation Committee; Director Vásquez was assigned to the Finance and Insurance Committee, Legal and Claims Committee, and Real Property and Asset Management Committee; Director Camacho was appointed Chair of the Real Property and Asset Management Committee. (Agenda Item 5G)

FINANCE AND INSURANCE COMMITTEE

Approved the draft Official Statements substantially in the form attached to the board letter, with changes approved by the General Manager and General Counsel; authorized the General Manager, or any designee of the Ad Hoc Committee, to execute the Official Statements; authorized distribution of the Official Statement in connection with issuance of the bonds; and authorized the Ad Hoc Committee or its designee to approve and the Chief Financial Officer to execute amendment and termination of interest rate swaps (in whole or in part) related to the subject refunding. (Agenda Item 8-1)

ENGINEERING AND OPERATIONS COMMITTEE

Appropriated $4.78 million; authorized preliminary design to rehabilitate Basins Nos. 5-8 at the Weymouth plant; and authorized final design to rehabilitate Basins Nos. 1-8 at the Diemer plant. (Agenda Item 8-2)

Appropriated $3.2 million; authorized construction of Diemer Oxidation Retrofit Program completion activities; authorized final design and permitting for revegetation of slopes at the Diemer plant; and authorized agreement with Helix Environmental Planning, Inc., in an amount not to exceed $310,000, for mitigation support services. (Agenda Item 8-3)

Adopted the attached resolution in the Board letter; and authorized the General Manager to enter into Renewable Auction Mechanism 3 Pro Forma Renewable Power Purchase and Sale Agreements with Edison under the terms described herein, with changes approved by the General Manager and General Counsel, for the sale of renewable output from the Red Mountain and Venice Hydroelectric Power Plants, if the General Manager determines the operational and financial requirements are acceptable. (Agenda Item 8-4)
CONSENT CALENDAR

In other action, the Board:

Authorized the General Manager to grant two permanent easements to Southern California Edison in Los Angeles and Orange Counties.  (Agenda Item 7-1)

Authorized the General Manager to amend the current license agreement with Desert Sunlight Holdings, LLC.  (Agenda Item 7-2)

Affirm the General Manager’s determination that one parcel consisting of 8.426 acres in the unincorporated community of Mentone in San Bernardino County, a portion of Metropolitan Water District of Southern California’s Parcel No. INFED 1-24-150 (APN 0299-111-02), is surplus to Metropolitan’s needs.  TABLED BY COMMITTEE (Agenda Item 7-3)

Authorized the General Manager to enter into a Local Resources Program agreement for the Round Mountain Water Treatment Plant with Calleguas Municipal Water District and Camrosa Water District for up to 1,000 acre-feet per year of recovered groundwater under terms included in the board letter.  (Agenda Item 7-4)

Adopted the resolutions to support WaterSMART grant applications and authorized the General Manager to accept funding and enter into agreements with Reclamation, if awarded.  (Agenda Item 7-5)

Appropriated $1.58 million; and authorized final design of enhanced bromate control systems for the Mills and Weymouth plants.  (Agenda Item 7-6)

Appropriated $920,000; and awarded $490,292.26 contract to Global Power Group, Inc. to replace the data center Uninterruptible Power Supply at Metropolitan’s Headquarters Building.  (Agenda Item 7-7)

Appropriated $225,000; and authorized final design of upgrades to the sodium hypochlorite feed system at Palos Verdes Reservoir.  (Agenda Item 7-8)

OTHER MATTERS

The Board authorized the preparation of Commendatory Resolution for Director Timothy F. Brick, representing the city of Pasadena. (Agenda Item 5F)

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.
February 19, 2013

Director Vincent Mudd
Director Keith Lewinger
Director Fern Steiner
Director Doug Wilson
San Diego County Water Authority
4766 Overland Avenue
San Diego, CA 92123

Dear Directors:

Your letter dated February 11, 2013, regarding Board Letter 8-1

This letter responds to your questions and comments to the January 30, 2013 draft of Appendix A to the Official Statements for Metropolitan’s Water Revenue Refunding Bonds, 2013 Series A and B and 2013 Series C, attached to Board Letter 8-1. Chairman Foley asked me to respond to your letter.

Answers to your questions about Metropolitan’s interest rate swaps and the proposed swap terminations, to the extent not fully addressed in the Finance and Insurance Committee discussion of this item on February 11, are in Metropolitan’s quarterly swap reports. The January 2013 report, for the quarter ended December 31, 2012, is posted at http://edmsidm.mwdh2o.com/idmweb/cache/MWD%20EDMS/003725136-1.pdf. We plan to provide a report at the April Finance and Insurance Committee meeting, when the next quarterly report will be available.

You also requested a report on Metropolitan’s investment policies. The Statement of Investment Policy must be updated and presented for Board approval annually, by law and pursuant to the Administrative Code. See Board Letter 8-1 approved on June 12, 2012. As explained in the Statement of Investment Policy, the California Government Code restricts the types and credit quality of investments that Metropolitan and other California local agencies may enter into. Metropolitan’s investment criteria are in fact more restrictive than Government Code requirements. The current Statement of Investment Policy is posted at http://edmsidm.mwdh2o.com/idmweb/cache/MWD%20EDMS/003722374-1.pdf.

We appreciate your acknowledgment of our changes to draft Appendix A in response to prior comments. Review by Board members is an important part of the process to update Appendix A. Comments from Board members, many from the Water Authority delegation, are discussed and
carefully evaluated, often resulting in clarifications or corrections to Appendix A. Your most recent comments and our responses are set forth below.

A-10: State Water Project operational constraints. Why is the last sentence of the first paragraph being deleted (the information is not outdated and remains relevant to July 2012 storage levels through July 2012)? Also, please reconcile the numbers reported in this paragraph with those contained in this month’s Water Planning and Stewardship Committee, Item 6a, PowerPoint Presentation slide 21 of 27, Attachment 3.

This paragraph now discusses cumulative estimated losses to the State Water Project due to pumping restrictions for the 2008-2012 period, as well as disclosure of losses affecting calendar year 2013 deliveries as of the end of January. Information about State Water Project storage as of July 1, 2012 was outdated. State Water Project storage as of January 1, 2013 is found under the heading, “Storage Capacity and Water in Storage.”

A-18: Sale of water by Imperial Irrigation District to SDCWA and MWD Exchange Agreement. The last sentence should be updated and corrected to reflect that IID did in fact meet its 2012 conservation obligation of 90,000 acre-feet, and, also delivered the additional 16,722 acre-feet of conserved water which MWD agreed to exchange and did exchange in 2012.

An update of this sentence is premature. We will revise it to be consistent with the Bureau of Reclamation’s 2012 accounting of Colorado River deliveries after that accounting is released.

A-26: Discrepancies between the draft Official Statement and MWD’s January 2013 WSDM staff report to Board of Directors RE MWD’s storage capacity and actual water in storage. The draft Official Statement reports MWD’s storage capacity to be 113,000 acre-feet lower and water in storage 4,000 acre-feet higher than MWD January 2013 Water Surplus and Drought Management report to the board of directors, Attachment 4. Please clarify the discrepancies.

The WSDM storage table and the Appendix A storage table are not intended to be apples-to-apples comparisons. The Appendix A storage table takes a longer-term view whereas the WSDM report is a short-term, month-to-month snapshot. The shorter-term WSDM report includes one-time or short-term capacity (Drop 2 reservoir storage credit that can only be used once and Article 56 carryover that is unpredictable over the longer term) that is not appropriate for the longer-term perspective of Appendix A. Appendix A includes capacity in the San Bernardino Valley Municipal Water District Coordinated Operating Agreement that was not included in the WSDM report because we do not plan to purchase water for storage under this agreement this year.
Also there are differences in timing. The Appendix A storage balances include regular accounting reconciliations for Lake Mead ICS and the DCWV Advance Delivery Account that were not available for the WSDM report table, resulting in a discrepancy of 4 TAF. There was a 3 TAF difference between the capacity listed for member agency storage programs in the two tables, some of which is attributable to rounding. We conformed Appendix A with the number in the WSDM report.

A-33: Replenishment and the sale of discounted water. It would be misleading to delete the discussion about a new storage program to replace the Replenishment Service Program unless these plans have in fact been abandoned by MWD and the member agencies. Just a few months ago, before the “rate refinement” process was terminated, MWD and the other member agencies had identified the sale of discounted water as a “top priority.” See Attachment 2, page 3 at A33 and A-52 and Attachment 1, page 6 at A-53.

We have restored a description of ongoing discussions.

A-44: Growth in number of unbudgeted MWD employees. Based on the edited numbers, MWD has added 93 employees since last October. Based on the presentation to the Board Budget Workshop on February 12, 2012, this number exceeds the budgeted employees by 45 employees (see slide, Attachment 5). What is the source of funding being used to pay the costs of the unbudgeted positions?

We have updated the employee count to February 13, 2013. Metropolitan has 33 fewer regular full-time employees as of that date than in October 2012. The numbers in the January draft were not correct.

A-48: Revised (“extended”) purchase orders as evidence of MWD’s projected water sales revenues. We believe it is misleading to discuss the revised Purchase Orders in the context of disclosures about MWD’s projected water sales revenues, for the reasons described in the letter from the Water Authority’s General Counsel to MWD’s General Counsel dated December 27, 2012, Attachment 6. Given that at least 19 of the 22 member agencies executing the revised Purchase Orders had already met the minimum revised purchase order commitment even before the extension, the revised Purchase Orders provide no meaningful assurances to investors about MWD’s future sales revenues.

The Purchase Orders set the Tier 1 limits of member agencies, as disclosed in this section. Purchase Orders were extended to keep the Tier 1/Tier 2 pricing signal in place. We have reorganized the paragraph and added a cross-reference to the description of the Tier 1/Tier 2 water supply rates to clarify this. We also made some clarifying edits in response to comments from co-bond counsel.
A-50: Source of funding to pay SDCWA to the extent it prevails in the litigation. MWD has not changed the following statement: “If Metropolitan’s rates are revised in the manner proposed by SDCWA in the complaint, other member agencies may pay higher rates unless other actions are taken by the board.” The Water Authority inquired about the basis of this statement when it was changed by MWD, because it is inconsistent with the claims being published by many MWD member agencies and at times by MWD itself. See Attachment 2, page 3 at A-50. Neither MWD nor its member agencies has explained why this change was made to the last draft Official Statement, which previously stated that, “If Metropolitan’s rates are revised in the manner proposed by SDCWA in the complaint, other member agencies would pay higher rates.” The language in the current draft Official Statement is inconsistent with the expectations described in the Fitch ratings that have just been assigned to MWD bonds [Friday, February 8, 2013 3:37 pm EST.]:

CASH RESERVES FOR RISK

The unrestricted cash amount above excludes additional restricted cash of $67.5 million that is set-aside for disputed amounts paid by the San Diego County Water Authority (SDCWA), which are the subject of ongoing litigation. To the extent the litigation is decided in favor of SDCWA and Metropolitan Water District must make a payment to SDCWA, Fitch anticipates that any settlement would be collected from other member agencies in a timely manner. The litigation relates to the rate methodology used to allocate costs between members. (Emphasis added.)

The expected source of money that would be used to pay SDCWA is a material fact; at a minimum, it is something we believe an investor would be interested in knowing when considering whether to invest in MWD bonds.

The statement that “other member agencies may pay higher rates unless other actions are taken by the board” recognizes the board’s discretion over rates and charges. As I explained in my letter to you on October 25, 2012, “The Board may authorize a variety of actions to replace lost revenues and close a budget shortfall, including raising rates, reducing costs, restructuring of rates and charges, and other options depending on the circumstances.” The Fitch report does not prescribe the source of any settlement paid to SDCWA, but assumes that the settlement amount would be recovered from other member agencies.

A-51: More on MWD purchase orders. See comments above at A-48. In addition, MWD should disclose during the discussion at A-51 that its largest customer (see footnote 1 at page A-2) – the Water Authority – signed the revised Purchase Order under protest, and why. Further, MWD should note that it rejected SDCWA’s execution of the revised
The Metropolitan Water District of Southern California

SDCWA Directors
February 19, 2013
Page 5

Purchase Order. See Attachment 7, letter from MWD General Counsel to SDCWA General Counsel dated January 4, 2013.

The existing disclosure that there are 22 Purchase Orders now in effect is accurate. SDCWA provided its Purchase Order extension under terms that showed its lack of consent to, and unwillingness to be bound by, the terms of the agreement, as described by Metropolitan’s General Counsel in Attachment 7 to your letter. Mutual consent is necessary to reach an effective agreement. However, the circumstances under which SDCWA’s existing purchase order expired are not material to investors.

A-52: Inaccurate, ex post facto characterization of how Replenishment Service Program was operated. The edits to the first sentence of the Replenishment section change the prior statement describing program objectives to an inaccurate statement of fact about purported benefits of the sale of discounted water as replenishment. See discussion at Attachment 1, page 6 at A-53 and Attachment 2, page 3 at A-33 and A-52.

We have revised this paragraph to take your comments into account.

A-55: MWD’s financial reserve policy, the use of “unrestricted reserves” as “collateral” and failure to establish a separate interest bearing account for SDCWA litigation deposits. It is not possible to confirm from the information and commingled descriptions provided at A-55 whether MWD is in compliance with its financial reserve policies. One thing that is clear is that MWD has failed to establish a separate interest bearing account for SDCWA litigation deposits as required by the Exchange Agreement. The very purpose of the requirement of a “separate interest-bearing account” was to restrict MWD’s use of those monies for other purposes. MWD has also failed to explain how reserve balances that are held as collateral can be described as “unrestricted.” See Attachment 1, page 8 at A-81. No response to this question has been provided by MWD.

I responded to your comment about collateral deposits in my November 19, 2012 letter. SDCWA litigation deposits also are accounted for in Metropolitan’s reserves. It is accurate to include them in the section discussing reserve deposits.

A-72: Inclusion of Bay Delta Conservation Plan construction costs in projected costs of MWD for State Water Project water. Please identify what construction costs have been included in the 2016 and 2017 projected costs for anticipated construction of additional State Water Project facilities.

See footnote 4 to the table, “Projected Costs of Metropolitan for State Water Project Water.”
A-74: Failure to raise rates to fund pension and Other Post Employment Benefits (OPEB) liabilities. As of January 1, 2011, MWD’s combined unfunded retiree health care obligation and unfunded pension liability is at least $757 million. When this number is next updated, the number will likely approach the $1 billion mark. Although there are many disclosures of fact in the draft Official Statement, the burden of this liability on future water ratepayers and the cost of water are not described. MWD’s plan to “begin OPEB funding above annual pay-as-you-go amounts with $5 million in the fiscal year 2012-13 budget” and statement that it “intends” to increase this amount by $5 million per fiscal year to an annual funding amount of $25 million beginning in fiscal year 2016-17 defies the reality of other statements that it will, at the same time, begin construction of the BDCP and hold rate increases to 3%. This estimate pales in comparison to MWD’s average annual rate increases of 5.6% over the past 30 years (1984-2014), and its average annual rate increases of 7.9% over the past 10 years (2004-2013). It is difficult to imagine that MWD will impose far lower annual rate increases, while at the same time invest billions of dollars more on its Bay Delta water supplies and begin modest payments to its unfunded OPEB liability. Further, given that the MWD board has not been willing to raise water rates now to pay for these liabilities, one is left to wonder why it will be willing to do so in the future at a time when MWD’s BDCP costs are substantial.

Metropolitan’s funding of its pension and OPEB costs, projected funding requirements from PERS, budget projections and actuarially-determined unfunded liability are fully disclosed. This disclosure is factual based on Metropolitan’s financial results and budget and PERS projections. The five-year budget projections already include a build-up of pension costs and a plan to fund the actuarially required contribution (ARC) for OPEB. Your statement in the above paragraph is speculative and unsupported by Metropolitan’s current projections. See our response to your next comment.

A-80: Management’s projections and assumptions concerning future events and circumstances that may impact MWD’s revenues and expenditures are unreasonable. Based on all of the detailed comments we have provided in regard to past draft Official Statements, and other resource planning and financial issues at MWD, we do not believe that management’s projections and assumptions as described in the draft Official Statement are reasonable. MWD’s continued reference to long-outdated planning documents in its Official Statement is a matter of concern to us and should be a matter of concern to investors, not the least of which is the 1999 Long Range Finance Plan which even MWD has abandoned as a planning document for board planning purposes. Aside from all of the data, simple common sense suggests that there is no way that MWD can do everything that it says it will do beginning in 2016 (IRP projects, construction of BDCP and increase payments to OPEB) and at the same time, hold rate increases to 3 percent – all at the same time its sales are down 25% and its member agencies are constructing and planning more local water supply
projects throughout Southern California to reduce their demand for increasingly expensive imported water supplies.

Metropolitan’s projections and assumptions described in Appendix A are founded on current Board-approved policies, approved budgets and current, conservatively-based projections. The Long Range Finance Plan, originally adopted in 1999, is cited as the source of the Metropolitan’s minimum/maximum financial reserve policy. This policy, as subsequently amended by the Board, is included in Administrative Code section 5202. The Integrated Resources Plan, most recently updated in October 2010, provides a framework for regional water resources development over a long-term planning horizon. It seeks to provide regional reliability through 2035, with regional collaboration, by stabilizing Metropolitan’s traditional imported water supplies, continuing to develop local resources, and providing adaptive long-term planning for contingency resources.

The biennial budget for fiscal years 2012-13 and 2013-14 and the five-year projections contained in the adopted budget provide funding for core IRP projects (such as construction costs for Bay-Delta conveyance anticipated to be paid by State Water Project contractors), local resources projects, and pension and OPEB. The budget and five-year forecast conservatively assume water sales at levels fifteen percent below Metropolitan’s long-term sales average. The twenty-five percent drop in sales cited in your letter compares a single-year low to a single-year peak, a less stable assumption than the long-term sales average. Moreover, the conditions that generated this drop (described in Appendix A) are returning to normal. Current year financial performance is exceeding expectations, illustrating the reasonably conservative level of Metropolitan’s water sales assumptions.

The projections cited in Appendix A indeed should cover costs of providing reliable supplemental water supplies for Metropolitan’s service area with annual average rate increases of 3-5 percent over the next five years, based on budget assumptions. Actual results are likely to differ from projections. The goal of each Official Statement is to disclose material current facts and reasonable projections, the bases for those projections and the factors that could affect future performance—all founded on reasonable assumptions.

We appreciate your careful review of the Official Statements.

Sincerely,

Gary Breaux
Assistant General Manager/Chief Financial Officer
SDCWA Directors
February 19, 2013
Page 8

cc: J. Kightlinger
    M. Scully
    MWD Board of Directors
    SDCWA Member Agencies
February 28, 2013

Attention: Imported Water Committee

Colorado River Board Representative’s Report (Information)

Purpose
The Colorado River Board (CRB) Representative’s Report summarizes monthly activities of the Colorado River Board.

Background
This report covers activities from the February 13, 2013 CRB meeting.

Discussion
The CRB heard informational reports from CRB staff on activities discussed below:

Water supply and reservoir operations
As of February 1, 2013 total system storage was 32.8 million acre-feet (maf), or 55 percent of capacity, which is about 5.5 maf less than a year ago. Lake Mead is 53 percent full, with 13.8 maf and Lake Powell is at 50% capacity with 12.2 maf. January 2013 releases from Hoover, Davis, and Parker Dames averaged 9,900, 8,300 and 5,720 cubic feet per second (cfs), respectively. Planned releases for February are 11,900, 11,400 and 8,300 cfs, respectively.

The preliminary 2012 end-of-year forecast by the Bureau of Reclamation estimates consumptive Colorado River water use by the Lower Division states as follows: Arizona, 2,796 maf; California, 4,420 maf; and Nevada, 0.236 maf.

Resignation of Interior Secretary Ken Salazar
The Secretary of the Department of the Interior, Ken Salazar, announced his resignation effective at the end of March 2013. Having fulfilled his four year commitment to President Obama, Mr. Salazar will return to his family in Colorado after eight years in Washington, D.C. Earlier this month President Obama selected Sally Jewell as his replacement. Since 2005 Ms. Jewell has served as the Chief Executive Officer of Recreational Equipment, Incorporated (REI). Prior to joining REI, Ms. Jewell served as a petroleum engineer with Mobil Oil Corporation and spent considerable time in the commercial banking industry.

Binational discussions
In November 2012, the U.S. and Mexico executed Minute 319 to the treaty between the two countries. The Minute provides surplus and shortage guidelines for Mexico, funds wildlife habitat in Mexico, develops a pilot program to conserve water in Mexico that would become available to U.S. users, and allows Mexico to store water in Lake Mead. Since the signing, Reclamation and the International Boundary and Water Commission (IBWC) have met to discuss the commitments contained in the Minute and are working on a plan for its implementation. This includes the development of several small teams consisting of representatives from the U.S. and Mexico to work on items such as water accounting and
operations and other specific projects. Reclamation and IBWC will coordinate these efforts with input from the Basin States and member agencies.

**Colorado River Basin Water Supply and Demand Study**
With the release of the Colorado River Basin Water Supply and Demand Study (Basin Study) in December 2012 the Basin States and Reclamation have begun to shift their focus to the “Future Considerations and Next Steps” components of the report. With a potential 3.2 maf Basin-wide imbalance of demands versus supplies by 2060, several ideas are being considered to address the issue. This includes educational workshops to help provide more information and clarification regarding the technical complexity and comprehensiveness of the Basin Study, the formation of small work groups to concentrate on “Municipal Conservation and Reuse” and “Agricultural Conservation and Transfers”, the potential establishment of an Upper basin Water Bank, and the continual evaluation of augmentation projects that have the potential to yield additional supplies or generate water savings. A Basin States’ Principals’ meeting is scheduled for early March to kick off these discussions.

**Status of the Lower Colorado River Water Supply Project**
The Lower Colorado River Water Supply Project (“Project”) was authorized by Congress in 1986 as a means to provide water to entities whose lands or interests in lands are located adjacent to the Colorado River in the State of California and who do not hold rights to Colorado River water or whose rights are insufficient to meet their present or anticipated future needs. The project was expanded in 2005 to allow additional entities who hold Section 5 contracts for municipal and industrial uses within the State of California.

Stage I of the project was substantially completed in 1996 and has the capacity to provide 5,000 acre-feet of water per year. In late January Reclamation provided a briefing to stakeholders on the planning status of Stage II of the Project at its Yuma Area Office. It was reported that the following has been completed for the 10,000 acre-foot per year project: (1) National Environmental Policy Act (NEPA) review; (2) consultation with the IBWC; (3) Endangered Species Act compliance; (4) drilling of the exploratory pilot hole; and (5) preparation of construction and design estimates, and development of the Stage II project schedule. Next steps include the installation of a Supervisory Control and Data Acquisition system for monitoring groundwater and the replacement of submersible pumps on the two existing wells. Reclamation estimates that these additional tasks will cost $1.9-$2.4 million and are expected to be completed over the next two years. Prior to construction, final project design and a project funding agreement will need to be completed.

Prepared by: Dan Denham, Principal Water Resources Specialist
Reviewed by: Halla Razak, Colorado River Program Director
Approved by: Michael T. Hogan, CRB Representative
Attachment: Summary Water Report, Colorado River Basin
## SUMMARY WATER REPORT
### COLORADO RIVER BASIN
#### February 1, 2013

<table>
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<th>RESERVOIR STORAGE (as of January 31)</th>
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<td>Flaming Gorge</td>
<td>2.981</td>
<td>6,020.0</td>
<td>3.002</td>
<td>6,020.6</td>
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<tr>
<td>Navajo</td>
<td>0.947</td>
<td>6,023.8</td>
<td>0.957</td>
<td>6,024.7</td>
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<tr>
<td>Lake Mead</td>
<td>13.828</td>
<td>1,122.3</td>
<td>13.636</td>
<td>1,120.4</td>
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<tr>
<td>Lake Mohave</td>
<td>1.650</td>
<td>641.2</td>
<td>1.572</td>
<td>638.3</td>
</tr>
<tr>
<td>Lake Havasu</td>
<td>0.580</td>
<td>448.0</td>
<td>0.550</td>
<td>446.4</td>
</tr>
<tr>
<td>Total System Storage</td>
<td>32.777</td>
<td>55</td>
<td>33.075</td>
<td>55</td>
</tr>
<tr>
<td>System Storage Last Year</td>
<td>38.323</td>
<td>64</td>
<td>38.365</td>
<td>64</td>
</tr>
</tbody>
</table>

### January 7, 2013

- **WY 2013 Precipitation (Basin Weighted Avg) 10/01/12 through 2/04/13**: 77 percent (9.3")
  74 percent (6.9")

- **WY 2013 Snowpack Water Equivalent (Basin Weighted Avg) on day of 2/04/13**: 83 percent (8.1")
  79 percent (5.6")

### January 3, 2013

- **February 4, 2013 Forecast of Unregulated Lake Powell Inflow**
  - 2013 April through July unregulated inflow: 4.000 56 %  4.400 61%
  - 2013 Water Year: 6.017 56 %  6.561 61%
ARIZONA, CALIFORNIA, NEVADA, MEXICO
FORECAST OF END OF YEAR CONSUMTIVE USE
FORECAST BASED ON USE TO DATE AND APPROVED ANNUAL WATER ORDERS

**WATER USE SUMMARY**

<table>
<thead>
<tr>
<th>State</th>
<th>Use To Date CY2012</th>
<th>Forecast Use CY2012</th>
<th>Approved Use CY2012</th>
<th>Excess to Approval CY2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>ARIZONA</td>
<td>2,795,615</td>
<td>2,795,423</td>
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<td>CALIFORNIA</td>
<td>4,419,093</td>
<td>4,418,977</td>
<td>4,175,000</td>
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<td>NEVADA</td>
<td>236,478</td>
<td>236,424</td>
<td>300,000</td>
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<td>STATES TOTAL</td>
<td>7,451,786</td>
<td>7,450,824</td>
<td>7,275,000</td>
<td>175,824</td>
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**MEXICO IN SATISFACTION OF TREATY**

<table>
<thead>
<tr>
<th>State</th>
<th>Use To Date CY2012</th>
<th>Forecast Use CY2012</th>
<th>Approved Use CY2012</th>
<th>Excess to Approval CY2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>TO MEXICO</td>
<td>1,460,108</td>
<td>1,591,258</td>
<td>1,500,000</td>
<td>91,258</td>
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<tr>
<td>MEXICO IN EXCESS OF TREATY</td>
<td>122,483</td>
<td>122,483</td>
<td>91,258</td>
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**BYPASS PURSUANT TO MINUTE 242**

<table>
<thead>
<tr>
<th>State</th>
<th>Use To Date CY2012</th>
<th>Forecast Use CY2012</th>
<th>Approved Use CY2012</th>
<th>Excess to Approval CY2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>YUMA MESA DIVISION</td>
<td>122,483</td>
<td>122,483</td>
<td>91,258</td>
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**TOTAL LOWER BASIN & MEXICO**

<table>
<thead>
<tr>
<th>Use To Date CY2012</th>
<th>Forecast Use CY2012</th>
<th>Approved Use CY2012</th>
<th>Excess to Approval CY2012</th>
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</thead>
<tbody>
<tr>
<td>9,034,377</td>
<td>9,164,565</td>
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</table>

1/ Incorporates Jan-Nov USGS monthly data and 76 daily reporting stations which may be reviewed after provisional data reports are distributed by the USGS. Use to date estimated for users reporting monthly and annually.
2/ These values reflect adjusted apportionments. See Adjusted Apportionment calculation on each state page.
3/ Includes unmeasured returns based on estimated consumptive use/diversion ratios by user from studies provided by Arizona Dept. of Water Resources, Colorado River Board of California, and Reclamation.

**Graph notes:** Jan 1 forecast use is scheduled use in accordance with the Annual Operating Plan's state entitlements, available unused entitlements, and over-run paybacks. A downward sloping line indicates use at a lower rate than scheduled, upward sloping is above schedule, and a flat line indicates a use rate equal to schedule. Lower priority users such as CAP, MWD, and Robt.B.Griffith may adjust use rates to meet state entitlements as higher priority use deviates from schedule. Abrupt changes in the forecast use line may be due to a diversion schedule change or monthly updating of provisional realtime diversions.
CALIFORNIA WATER USERS
FORECAST OF END OF YEAR CONSUMPTIVE USE
FORECAST BASED ON USE TO DATE AND APPROVED ANNUAL WATER ORDERS

California Schedule and Approvals
Historic Use Records (Water Accounting Reports)

<table>
<thead>
<tr>
<th>WATER USER</th>
<th>Use To Date CY2012</th>
<th>Forecast Use CY2012</th>
<th>Estimated Use CY2012</th>
<th>Excess to Estimated Use CY2012</th>
<th>Diverion To Date CY2012</th>
<th>Forecast Diversion CY2012</th>
<th>Approved Diversion CY2012</th>
<th>Excess To Approved Diversion CY2012</th>
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<tbody>
<tr>
<td>CALIFORNIA PUMPERS</td>
<td>2,087</td>
<td>2,066</td>
<td>2,066</td>
<td>--</td>
<td>3,772</td>
<td>3,735</td>
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<td>FORT MOJAVE INDIAN RESERVATION, CA</td>
<td>9,893</td>
<td>9,893</td>
<td>9,893</td>
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<td>16,572</td>
<td>16,572</td>
<td>16,720</td>
<td>-148</td>
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<td>CITY OF NEEDLES (includes LCWSP use)</td>
<td>1,991</td>
<td>1,960</td>
<td>1,950</td>
<td>0</td>
<td>2,328</td>
<td>2,283</td>
<td>2,270</td>
<td>-437</td>
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<td>METROPOLITAN WATER DISTRICT</td>
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<td>735,463</td>
<td>631,986</td>
<td>100,477</td>
<td>738,127</td>
<td>738,127</td>
<td>638,097</td>
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<td>COLORADO RIVER INDIAN RESERVATION, CA</td>
<td>3,741</td>
<td>3,705</td>
<td>3,450</td>
<td>--</td>
<td>9,438</td>
<td>9,345</td>
<td>9,345</td>
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<td>PALO VERDE IRRIGATION DISTRICT</td>
<td>366,529</td>
<td>366,529</td>
<td>372,958</td>
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<td>897,181</td>
<td>897,181</td>
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<td>47,707</td>
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<td>96,323</td>
<td>96,323</td>
<td>104,000</td>
<td>-7,677</td>
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<td>YUMA PROJECT RESERVATION DIVISION - INDIAN UNIT</td>
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<td>--</td>
<td>--</td>
<td>--</td>
<td>43,672</td>
<td>43,672</td>
<td>48,500</td>
<td>-4,828</td>
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<tr>
<td>YUMA PROJECT RESERVATION DIVISION - BARD UNIT</td>
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<td>--</td>
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<td>52,651</td>
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<tr>
<td>YUMA ISLAND PUMPERS</td>
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<td>FORT YUMA INDIAN RESERVATION - RANCH 5</td>
<td>748</td>
<td>702</td>
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<td>1,353</td>
<td>1,269</td>
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<td>117</td>
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<td>IMPERIAL IRRIGATION DISTRICT</td>
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<td>168,353</td>
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<td>2,903,245</td>
<td>2,800,662</td>
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<td>SALTON SEA SALTINITY MANAGEMENT</td>
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<td>9,438</td>
<td>9,345</td>
<td>9,345</td>
<td>0</td>
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<tr>
<td>COACHELLO VALLEY WATER DISTRICT</td>
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<td>329,017</td>
<td>342,000</td>
<td>-12,983</td>
<td>344,966</td>
<td>344,966</td>
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<td>OTHER LCWSP CONTRACTORS</td>
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<td>635</td>
<td>635</td>
<td>--</td>
<td>1,016</td>
<td>1,006</td>
<td>1,006</td>
<td>0</td>
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<tr>
<td>CITY OF WINTERHAVEN</td>
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<td>72</td>
<td>72</td>
<td>--</td>
<td>109</td>
<td>108</td>
<td>108</td>
<td>0</td>
</tr>
<tr>
<td>CHEMHEUVEI INDIAN RESERVATION</td>
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<td>128</td>
<td>6,101</td>
<td>--</td>
<td>11,453</td>
<td>11,340</td>
<td>11,340</td>
<td>0</td>
</tr>
</tbody>
</table>

TOTAL CALIFORNIA | 4,420,024 | 4,420,325 | 4,186,036 | 234,289 | 5,150,205 | 5,054,613 | 4,874,714 | -- |

FORT YUMA INDIAN RESERVATION /1 | -- | -- | -- | -- | 48,762 | 48,676 | 53,387 | -4,711 |

CALIFORNIA ADJUSTED APPORTIONMENT CALCULATION
California Basic Apportionment
4,400,000
MWD storing NV unused
-25,000
Intentionally Created Surplus Water (IID)
Creation of Extraordinary Conservation ICS (MWD)
-200,000
Total State Adjusted Apportionment
4,175,000
Excess to Total State Adjusted Apportionment
245,325

ISG ANNUAL TARGET COMPARISON CALCULATION
Priorities 1, 2, 3b Use (PVID+YPRD+Island+PVID Mesa) 420,896
MWD Adjustment -896
Total California Agricultural Use (PVID+YPRD+Island+IID+CVWD) 3,651,582
California ICS Creation (IID ICS) 25,000
MWD Adjusted Total California Agricultural Use 4,150
Total California Agricultural Use (PVID+YPRD+Island+IID+CVWD) 3,651,582
MWD-CVWD Exchange
Total Use for Target Comparison2 3,690,186
ISG Annual Target (Exhibit B) 3,470,000
Amount over/(under) ISG Annual Target 220,186

NOTES:
1/ Fort Yuma Indian Reservation includes Yuma Project Reservation Division Indian Unit, Ranch 5, an estimate of domestic use and pumpers
2/ Includes MWD Adjustment, California Agricultural Use and Paybacks, IID-CVWD covered PPRs, and taking out the MWD-CVWD Exchange

01/09/13 U.S. BUREAU OF RECLAMATION
LOWER COLORADO REGION
PROVISIONAL CY2012

NOTE:
• Diversions and uses that are pending approval are noted in red italics.
• Water users with a consumptive use entitlement - Excess to Estimated Use column indicates overrun/underrun of entitlement. Dash in this column indicates water user has a diversion entitlement.
• Water user with a diversion entitlement - Excess to Approved Diversion column indicates overrun/underrun of entitlement. Dash in this column indicates water user has a consumptive use entitlement.
Figure 1. Total Colorado River Basin Storage as of February 2013

* A resurvey of Lake Powell changed the MUC and MOL in June 1991
Figure 2. Lakes Powell and Mead Monthly Pool Elevation Levels

**Lake Powell Monthly Pool Elevation Level**
*Feet*

- Maximum (3700 feet)
- Upper Elevation Balancing Tier (3645 feet)
- Lower Elevation Balancing Tier (3525 feet)

*3555.90 ft. in March 2005, lowest since 1969 during the initial filling of Lake Powell.*

**Lake Mead Monthly Pool Elevation Level**
*Feet*

- Maximum (1229 feet)
- Surplus (1145 feet)
- Normal Condition
- Shortage (1075 feet)

*1081.94 ft. in November 2010, lowest since 1937 during the initial filling of Lake Mead.*
Figure 3. SNOTEL Water-Year-To-Date (WYTD) SWE for the CO headwaters basin
Figure 4. NOAA National Weather Service Monthly Precipitation Maps for December 2012 and January 2013
Figure 5. USDA United States Drought Monitor Map

U.S. Drought Monitor

February 5, 2013
Valid 7 a.m. EST

The Drought Monitor focuses on broad-scale conditions. Local conditions may vary. See accompanying text summary for forecast statements.

http://droughtmonitor.unl.edu/

U.S. Drought Monitor

West

February 5, 2013
Valid 7 a.m. EST

The Drought Monitor focuses on broad-scale conditions. Local conditions may vary. See accompanying text summary for forecast statements.

http://droughtmonitor.unl.edu
Sacramento

Legislation

The Legislative deadline for bill introduction was this past Friday, February 22. There were 2,189 bills introduced - which works out to about 19 bills per author. We are currently reviewing all of the newly introduced proposals and plan to bring a number of bills back to the Board in March for consideration.

Our sponsor proposal dealing with recycled water is AB 613 by Assembly Member Hueso. We have spent significant time over the past month and a half working with various stakeholders, including key legislative staff to try and refine the original language into something that could address the problems raised while also making it through the legislative process. The bill is currently a spot measure (non-substantive language in the bill currently) while we finalize language.

The second sponsorship proposal dealing with the California Air Resources Board (CARB) and how carbon auction funds are rebated to water agencies has been put on hold. We had been working with various members of the San Diego legislative delegation but concerns were raised about the likelihood of a stand-alone bill given the position of the Governor and his plan for a stakeholder process to determine the best use of revenues from the cap and trade auction. At this time, we plan to work with legislative leadership on how our issues can be addressed through a broader, more comprehensive approach as well as participating in the CARB scoping process.

Water Bond

Speculation continues as to what might or might not happen this year as it relates to the reframing of the 2014 water bond. We are working closely with ACWA and other stakeholders to ensure that San Diego's interests are represented in whatever develops for
a new bond proposal. Given the current discussions, it is unlikely that project specific allocations will stay in a bond as it develops. That said, the Sacramento lobbying team is unsure if a water bond re-do will happen this year given the Legislature’s tendency to wait until the last minute to address an issue, so the real bond discussions may not happen until the spring or summer of 2014.

Washington, DC

Fiscal Fights to Take Center Stage in March

After a two-month delay and no apparent progress in making a deal to prevent them, the Fiscal Year 2013 sequestration cuts appear likely to begin on March 1. Nondefense discretionary programs will be cut by $28.7 billion, or 5.8 percent, in 2013. Total cuts under the sequestration law in 2013 will be $85.4 billion.

The full impact of the sequestration is difficult to estimate at this time, for both specific programs and in the aggregate. All discretionary programs are currently being funded through a temporary Continuing Resolution through March 27.

Federal departments will not announce most FY2013 grant awards until after FY2013 appropriations are finalized. Many programs cut under the sequestration could be replenished through offsetting cuts to other programs as part of the final FY2013 spending bills. Congress may prioritize cuts or provide federal departments additional flexibility to prioritize cuts as part of the final FY2013 spending plan. Failure to reach a deal by March 27 could result in a full shut down of the federal government beginning March 28. At present, Congress is scheduled to begin a recess on March 25.

Most attention on sequestration has focused upon furloughing of federal employees. However, under labor agreements with many employee groups, a 30-day notice is required before a reduction in service could begin. While the White House and federal departments have outlined the potential impact of sequestration, it is still unknown what the actual, immediate, impact will be after March 1.

Senator Feinstein Receives Appropriations’ Appointments

The Senate Committee on Appropriations made its subcommittee assignments. Senator Feinstein will again chair the Energy & Water Development Subcommittee. She will also serve on the Interior & Environment; Agriculture & Rural Development; Commerce, Justice, State; Defense; and Transportation, Housing, and Urban Development subcommittees.

Members Call for New Cost Benefit Analysis of BDPC Alternative Plans

In a February 13 letter to Interior Secretary Ken Salazar and Acting Commerce Secretary Rebecca Blank, six members of California congressional delegation asked for a cost-
benefit analysis of alternative proposals for the Bay Delta Conservation Plan (BDCP). Representatives Jerry McNerney, John Garamendi, Ami Bera, Doris Matsui, George Miller and Mike Thompson wrote that analysis of a number of alternatives, including the proposal from the Natural Resources Defense Council and an alternative that includes no tunnel conveyance system, is needed to provide a full picture and develop the best plan for the state.

The letter said that “Analyzing only the state’s preferred alternative, which is estimated to cost upwards of $18 billion and affect water reliability for the entire state, is irresponsible and further illustrates yet again that the broader concerns and needs of the Bay-Delta region are being left out of the discussion.”

Sacramento-San Joaquin Delta Water Planning

The Bureau of Reclamation filed its final environmental review of a proposal to transfer up to 150,000 acre-feet of water from land fallowing and conservation activities in the Delta over the next 25 years. The water would be available to wildlife refuges, municipalities, industry, or agriculture.

The U.S. Army Corps of Engineers also announced that it would begin its own environmental review for ecosystem restoration and flood protection in the Delta. Public meetings will begin this month with a draft review completed in 2014.

Higher Costs for Hoover Dam Electricity

The Department of Energy is proposing a five percent rate increase for power generated by the Hoover Dam, in part because of low water levels in Lake Mead have cut the amount of power generated by the dam. Details about the proposed increase will be available at a public meeting March 27 in Phoenix.

Obama Announces Nominee to Head Interior

President Obama announced the nomination of Sally Jewell to head the Department of the Interior. Jewell is the current president and CEO of Recreational Equipment, Inc. (REI). She has little formal experience in resource policy, but has been involved with a number of environmental and conservation groups. She began her career as a petroleum engineer for Mobil Oil. The Senate Committee on Energy and Natural Resources has scheduled a hearing to consider Jewell’s nomination on March 7.

Current Secretary Ken Salazar is expected to stay at Interior until his replacement is confirmed.
WIFIA Legislation Reintroduced In Senate

Senator Jeff Merkley (D-OR) introduced the “Water Infrastructure Finance and Innovation Act of 2013,” or “WIFIA.” The bill, S. 335, is nearly identical to the WIFIA legislation Merkley sponsored in the last Congress. The new version clarifies that tribal communities are eligible to apply for WIFIA loans. The proposed bill is intended to speed up investment in water infrastructure by addressing what the bill says is a funding gap for large water projects of regional and national significance.

Under S. 335, EPA would operate the WIFIA program independent of the existing Drinking Water and Clean Water State Revolving Funds (SRFs). While the agency would continue to distribute SRF funds to states as it does today, EPA would separately offer low-interest loans to “regionally significant” water infrastructure projects following a nationwide competitive application process. The proposal broadly offers eligibility to any project to “construct, replace, or rehabilitate” a water or wastewater system, but the minimum WIFIA loan would be $20 million in order to focus the program on large-scale projects. The bill also would encourage – but not require – communities to consider using green infrastructure approaches where possible.

A broad range of projects would be eligible for these WIFIA loans, such as construction and/or improvement of water treatment infrastructure or community water systems; protection of groundwater and surface sources; implementation of water efficient, energy efficient or renewable generation technologies; and wastewater and storm water reuse and control.

Like his earlier bill, S. 335 would require projects receiving WIFIA funds to abide by Davis-Bacon wage rates and follow “Buy American” rules for iron, steel and manufactured products used in the projects’ construction.

Senator Merkley will be working with Senate Environment and Public Works Committee Chairman Boxer to incorporate WIFIA into a larger water infrastructure bill she hopes to move through the committee this year. Work on that larger bill, the Water Resources Development Act, could begin within the next few weeks.

One estimate prepared by the American Water Works Association, the Water Environment Federation, and the Association of Metropolitan Water Agencies showed that WIFIA would generate savings the equivalent of a 16 percent grant in comparison to typical municipal financing options and rates.