



● **Board of Directors**
Finance and Insurance Committee

4/10/2018 Board Meeting

8-2

Subject

Adopt CEQA determination and approve suspension of billing and collection of the Water Stewardship Rate on exchange agreement deliveries to San Diego County Water Authority for (a) calendar years 2019 and 2020 during the Demand Management cost allocation study period, and (b) calendar year 2018

Executive Summary

This letter recommends approval of the proposal to suspend the billing and collection of the Water Stewardship Rate on exchange agreement deliveries to the San Diego County Water Authority (SDCWA) in calendar years 2018, 2019, and 2020, pending Metropolitan's completion of a cost allocation study of its Demand Management costs. This approach is not mandated by the Court of Appeal decision in the *SDCWA v. Metropolitan* litigation, but staff believes it is the most equitable approach given the state of information at this time and the guidance received from the Court of Appeal.

Details

Exchange Agreement

The 2003 Amended and Restated Exchange Agreement (exchange agreement) between Metropolitan and SDCWA sets the price Metropolitan charges SDCWA for exchanging conserved water made available to SDCWA from the Imperial Irrigation District and canal lining, with water Metropolitan delivers to SDCWA, at Metropolitan's transportation rates. The transportation rates are the System Access Rate, System Power Rate, and Water Stewardship Rate. This price term was in exchange for benefits Metropolitan provided to SDCWA.

The exchange agreement also provides that in the event of a dispute over price, SDCWA will make payments when due and Metropolitan will set aside the disputed payments and interest earned thereon during the pendency of the dispute.

***SDCWA v. Metropolitan* Litigation**

On June 21, 2017, the Court of Appeal entered a decision in *SDCWA v. Metropolitan*, 12 Cal.App.5th 1124. The appellate court ruled Metropolitan may collect State Water Project transportation costs as part of Metropolitan's System Access Rate and System Power Rate. Accordingly, the System Access Rate and System Power Rate proposed for calendar years (CY) 2019 and 2020 comply with that ruling and it is proposed that Metropolitan will continue to collect State Water Project transportation costs in these transportation rates. Also as a result of the appellate ruling, Metropolitan no longer sets aside SDCWA's System Access Rate and System Power Rate payments under the exchange agreement.

The appellate court also found the administrative record before it for the rates in CYs 2011 through 2014 did not support Metropolitan's Water Stewardship Rate allocation to transportation rates, but the court did not address the allocation in subsequent years based on a different record. Metropolitan's policies have supported the belief that conservation and local resource development reduce the demand for imported supplies, which reduces the costs to build, expand, operate, and maintain transportation facilities. This has a regional benefit for all member agencies throughout Southern California. Metropolitan's Water Stewardship Rate for CYs 2015 through 2018 was

allocated to transportation rates based on a different administrative record than the record before the appellate court. The proposed Water Stewardship Rate for CYs 2019 and 2020 also has been allocated to transportation rates based on a different administrative record. Metropolitan continues to set aside SDCWA's disputed Water Stewardship Rate payments under the exchange agreement.

Demand Management Cost Allocation Study Period

The issue of avoided costs and their application to transportation rates was not actively briefed or litigated in the cases between Metropolitan and SDCWA. The current administrative record supports the allocation of the Water Stewardship Rate to transportation rates. Nonetheless, staff believes that based on the appellate court decision, this matter merits further study. Accordingly, staff will undertake an internal process with input from the member agencies to further study and determine the most appropriate cost allocation of the Demand Management cost function that is recovered through the Water Stewardship Rate. This will be an open and transparent process with scheduled workshops and will allow for review and comment by all member agencies, Metropolitan's Board, and the public. The process may take up to two years and staff expects to propose that the results be incorporated in the next biennial budget and rate setting cycle.

Proposal to Suspend Billing and Collection of the Water Stewardship Rate on Exchange Agreement Deliveries to SDCWA During the Study Period

During the time of the study period, it is proposed that Metropolitan suspend the billing and collection of the Water Stewardship Rate on exchange agreement deliveries to SDCWA. The suspension would apply to billing and collections for CYs 2018, 2019, and 2020 pending completion of the study. For CY 2018, the suspension would be retroactive to January 1, 2018.

The Water Stewardship Rate would continue to be a part of Metropolitan's full service water rate and the rate for wheeling service. This issue would be revisited in the next biennial budget and rate setting cycle for CYs 2021 and 2022 when the decision by Metropolitan's Board would be informed by the completed study of the Demand Management cost function.

The total effect of the proposed suspension, taking into consideration the lower revenues over the three calendar years, could be up to approximately \$46 million as shown in Table 1 below. The CY 2018 amount includes a refund to SDCWA of Water Stewardship Rate payments Metropolitan already collected for exchange agreement deliveries since January 1, 2018. If collected, these amounts would have been held in the exchange agreement set-aside fund during the pendency of the parties' dispute and, to the extent retained by Metropolitan upon resolution of the dispute, placed in the Water Stewardship Fund.

Table 1: Suspension of Water Stewardship Rate on Exchange Agreement Deliveries to SDCWA

	CY 2018	CY 2019	CY 2020	Total
Exchange Deliveries, AF	212,000	242,000	274,000	728,000
WSR Revenues on Exchange	\$11,660,000	\$16,698,000	\$17,810,000	\$46,168,000

If the proposal to suspend the billing and collection of the Water Stewardship Rate during the study period is not approved, then SDCWA's disputed Water Stewardship Rate payments would continue to be collected from SDCWA and held in the exchange agreement set-aside fund, along with SDCWA's disputed Water Stewardship Rate payments since January 2011, and interest earned thereon.

Policy

Metropolitan Water District Administrative Code Section 4304: Apportionment of Revenues and Setting of Water Rates

Metropolitan Water District Administrative Code Section 5107: Biennial Budget Process

California Environmental Quality Act (CEQA)

CEQA determination for Option #1:

The proposed action is not defined as a project under CEQA (Public Resources Code Section 21065, State CEQA Guidelines Section 15378) because the proposed action will not cause either a direct physical change in the environment or a reasonably foreseeable indirect physical change in the environment and it involves the creation of government funding mechanisms or other government fiscal activities which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment (Section 15378(b)(4) of the State CEQA Guidelines). In addition, where it can be seen with certainty that there is no possibility that the proposed action in question may have a significant effect on the environment, the proposed action is not subject to CEQA (Section 15061(b)(3) of the State CEQA Guidelines).

The CEQA determination is: Determine that the proposed action is not defined as a project under Public Resources Code Section 21065 and State CEQA Guidelines Section 15378(b)(4), and is not subject to CEQA pursuant to Section 15061(b)(3) of the State CEQA Guidelines.

CEQA determination for Option #2:

None required

Board Options

Option #1

Adopt the CEQA determination that the proposed action is not defined as a project and is not subject to CEQA, and

Approve suspension of billing and collection of the Water Stewardship Rate on exchange agreement deliveries to San Diego County Water Authority for (a) calendar years 2019 and 2020 during the Demand Management cost allocation study period, and (b) calendar year 2018.

Fiscal Impact: An estimated reduction in Water Stewardship Rate revenues from SDCWA's exchange agreement payments, of \$11.7 million in CY 2018, including refund of any Water Stewardship Rate amounts already paid for CY 2018 exchange agreement deliveries; \$16.7 million in CY 2019; and \$17.8 million in CY 2020. If collected, these amounts would have been held in the exchange agreement set-aside fund until resolution of the dispute.

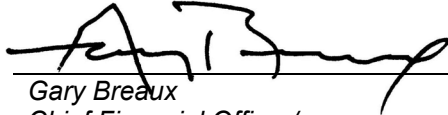
Option #2

Do not approve the proposal to suspend the billing and collection of the Water Stewardship Rate on exchange agreement deliveries to SDCWA during the Demand Management cost allocation study period for CYs 2018, 2019, and 2020.

Fiscal Impact: None. Continue to collect and set aside in the exchange agreement set-aside fund SDCWA's disputed Water Stewardship Rate payments for CYs 2018, 2019, and 2020 under the exchange agreement, until resolution of the dispute.

Staff Recommendation

Option #1



Gary Breaux
Chief Financial Officer/
Assistant General Manager

4/4/2018

Date



Jeffrey Kightlinger
General Manager

4/4/2018

Date

Ref# cfo12658693