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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Edward S. Meighan
for EXECUTIVE SECRETARY

May 6, 1996

To: Board of Directors (Water Planning and Resources Committee--Information)

From: General Manager *Edward S. Meighan*

Submitted by: Debra C. Man, Chief
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Subject: Rate Refinement Process Update

RECOMMENDATION

For information only.

EXECUTIVE SUMMARY

The Rate Refinement process was initiated in January 1996 to resolve issues of financing the resources and facility strategies of the approved Integrated Resources Plan. This process involves a series of facilitated discussions among Metropolitan and representatives of the member agencies, as well as policy guidance from a Board Task Force. The discussions have been led by Mr. James Waldo, who guided the successful Bay/Delta negotiations. The Rate Refinement negotiations have occurred over the past four months and have involved over 100 hours of discussions. Three major issues have been addressed in the process:

- (1) Refinements to the existing structure including alternatives to the New Demand Charge, modifications of the the Readiness-To-Serve (RTS) charge to address the incentive to "roll-off", seasonal storage rates, and agricultural discounts.
- (2) Cost Containment alternatives for Metropolitan's Capital Improvement Program, Operating and Maintenance costs, and water management programs, reflecting lower demand projections and the commitment of member agencies to fund such programs.
- (3) The need for Metropolitan and its member agencies to develop revenue sources other than those derived from the sale of water.

Recommendations on rate refinement issues involving changes to existing rates and charges will be developed by the Rate Refinement Team by the end of May 1996. A recommended proposal for rates and charges that would provide a bridge period of up to five years is expected to be provided for your Board's consideration in June, with action anticipated in July. Because of complexities in implementing long-term revisions to the rate structure and the need to conduct further analysis of the San Diego Water Exchange Proposal on rates and charges, a second phase of discussions will continue through the summer. Pursuant to the cost containment efforts, technical reports and analyses on Inland Feeder and the Ozone Retrofit program will be presented for review and consideration in the July/August timeframe. Preliminary recommendations regarding alternative revenues and long-term revenue changes are expected to be presented for your Board's consideration and review by the end of the year.

DETAILED REPORT

1. Process and Objectives

In December 1993, your Board approved a change in Metropolitan's rate structure to support the capital expansion program and meet Metropolitan's water management and revenue objectives. This structure included new charges to help reduce Metropolitan's reliance on the sale of water (the RTS and connection maintenance charge), as well as a charge to help ensure that agencies with growing dependence on Metropolitan pay their fair share of the capital costs associated with meeting those increased demands (New Demand Charge). In March 1995, the rates and charges under this new structure were approved by your Board for implementation in July 1995. With the completion of the Integrated Resources Planning (IRP) process and your Board's approval of the IRP as a policy guideline in January 1996, it was important to link the capital needs and water resource programs to the revenue structure necessary to support the water supply reliability and quality objectives identified in the IRP.

Metropolitan and its member agencies agreed to work through a facilitated process, which was initiated in January 1996, to consider refinements to the rate structure. These refinements would help reduce complexity, while increasing certainty regarding the cost of Metropolitan service. Participants in the facilitated process include Metropolitan staff and general managers and staff from the San Diego County Water Authority, Western Municipal Water District, Municipal Water District of Orange County, Calleguas Municipal Water District, Central and West Basin Municipal Water Districts, the cities of Fullerton, Long Beach, Los Angeles, Santa Monica, and Foothill Municipal Water District. Some of the member agency participants also have the responsibility of representing the interests of the other member agencies in their geographic area. In addition, the Chairman of the Board also appointed a Board Task Force to provide policy guidance to the process and facilitate communication with the Board. James Waldo of Gordon, Thomas, Honeywell is serving as the facilitator for the process.

The goal of the Rate Refinement Team is to develop a set of recommendations for consideration by the Metropolitan Board that would improve the existing rate structure. Specific

issues include the impact of the rate structure on decisions to purchase water for storage, the added complexity of the new structure, the overall level of rates and charges, the commitment of member agencies to pay for Metropolitan's capital program and water management initiatives and the variability of annual revenue necessary to meet Metropolitan's yearly revenue requirement.

2. Preliminary Results

The discussions have been divided into three major areas. The first concerns the manner in which Metropolitan charges for service -- changes to the rate structure that may be termed true refinement of the existing rate structure. Such change includes revising the New Demand Charge to eliminate the incentive to avoid purchasing Metropolitan water, addressing the "roll-off" provisions of the RTS formula, and setting the relative cost of water for storage and firm deliveries.

A second area of discussion has centered on the overall level of rates and charges. These discussions have been described as Cost Containment, and focus on Metropolitan's capital program and operating expenses, with the objective to reduce the annual cost of service, while continuing to meet Metropolitan's reliability and water quality objectives. The Cost Containment effort has resulted in the re-evaluation of capital improvement financing and project schedules, as well as additional decision packages and analyses of the major capital facilities which will be presented for the Board's consideration in the July or August time period. In particular, more detailed analysis of the Ozone Retrofit program and the Inland Feeder project are being prepared. Preliminary results indicate that the overall cost of imported water can be expected to increase at less than 2.5 percent per year, or less than the forecasted rate of inflation.

The third area of discussion concerns the evaluation of significant changes in the rate structure. These discussions include the development of alternative revenue streams, such as taxes, connection fees, and new revenues derived from the sale of services other than water service. While it is recognized that these sources will not be available in the near-term, the Rate Refinement Team is considering the feasibility of implementing such revenue sources over the next five years. In addition to alternative revenues, other concepts under consideration by the Rate Refinement Team include a Minimum Purchase Commitment program and other long-term arrangements to clearly define the level of financial commitment by the member agencies to the Metropolitan capital program and Metropolitan's obligations to provide service.

3. Schedule and Timing

The participants are considering a phased approach to achieving resolution of these issues. The facilitator is preparing a proposal for consideration by the Rate Refinement Team. This proposal would include descriptions of unresolved issues and plans for addressing them, recommendations for refinements to the existing rate structure, including changes to the New Demand Charge, RTS, and recommendations regarding the seasonal storage and agricultural rate levels. It is anticipated that these revisions would provide up to a five-year period of relative stability regarding rates and charges. As a result, member and sub-agencies would have the ability

to proactively respond to changes of a more long-term nature, such as a Minimum Commitment Purchase program. The facilitator's proposal will be discussed and finalized on May 23, 1996. This proposal will be provided for the Board's initial review at the June Board meeting with action anticipated in July.

The second phase of the discussions would deal with those issues that will take longer to achieve. These issues include the Minimum Purchase Commitment program, alternative revenue sources, rate issues related to the San Diego County Water Authority's Water Exchange Proposal and finalizing the cost containment efforts. The second phase of discussions is anticipated to extend into the fall of 1996. Recommendations regarding alternatives to Metropolitan's current revenue program should be provided to your Board by the end of the year.

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