FILED
by the Board of Directors of
The Metropolitan Water District
of Southern California
at its meeting held

41308

MAY 14 1996

9-11

MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

EXECUTIVE SECRETARY

April 30, 1996

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

From: General Manager

Submitted by: Debra C. Man, Chief
Planning and Resources Division

Subject: Deregulation of the Electric Utilities

RECOMMENDATION

For information only.

EXECUTIVE SUMMARY

As discussed in the February 1996 Board Letter (9-16) the electric utility industry is undergoing significant changes in parallel restructuring efforts which are intended to decrease costs to the consumer and allow the consumer to choose who will service such consumer's electric utility needs. Both the Federal Energy Regulatory Commission and the California Public Utilities Commission (CPUC) are currently in a rulemaking process to address issues of stranded investment, open access transmission, real-time information networks, independent system operator and a power exchange.

The impact of the CPUC restructuring on Metropolitan's power operations and power cost still remains unknown. It is believed that additional opportunities may arise from the deregulation process but, along with such opportunities comes changes which could result in cost increases for existing contracts and tariff schedules. Staff is continuing to monitor the various processes and will inform the Board when additional information is available. An action plan has been developed which outlines activities Metropolitan will undertake in the restructuring process to protect its interests and take advantage of opportunities to reduce the cost of electricity to Metropolitan. A gantt chart showing staff's major planned activities and estimated time line is shown in Attachment I. Attachment II outlines Managing Risks of Electric Industry Restructuring for Metropolitan.

DETAILED REPORT

As previously discussed the Federal Energy Regulatory Commission's (FERC) Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking (Mega-NOPR) is developing rules to govern open access to transmission and stranded investments. FERC has jurisdiction over transmission rates and access, and jurisdiction over wholesale power generation. This jurisdiction is generally limited to investor-owned utilities (IOUs) but the jurisdiction has been broadened by the Energy Policy Act of 1992 (EPAct). The final rule was adopted by the FERC on April 24, 1996 and will be published in the Federal Register in approximately ten (10) days from April 24th. Staff is monitoring this process and will be evaluating the rule once it is published. Metropolitan will have 60 days from the date of publishing in the Federal Register to comment on this rule.

The California Public Utilities Commission (CPUC) is trying to decrease the cost of electricity in the State of California and began a restructuring process on April 20, 1994 and issued its decision on the restructuring on December 20, 1995. The CPUC has jurisdiction over the IOUs in the State of California except where FERC already has jurisdiction. Metropolitan has developed an action plan, as discussed below, to see it through this restructuring process.

Metropolitan's Power Requirements and Generation

Metropolitan has four power components which are required to deliver and distribute water to its member agencies. The components which either generate or require electricity consist of: 1) the Colorado River Aqueduct (CRA); 2) the State Water Project (SWP); 3) the small hydroelectric generating units in the distribution system; and 4) the filtration plants and other various loads which require electricity.

The CRA requires approximately 2,600 gigawatt-hours (GWH) to pump 1.3 million acre-feet (MAF) of Colorado River water annually. Metropolitan has negotiated long-term firm contractual agreements for approximately 21% of the power output from the Hoover Power Plant and 50% of the power output from the Parker Power Plant along with economy energy agreements, this generation is sufficient to pump Metropolitan's Colorado River water to the basin. The pumping plants on the CRA receive their electricity through Metropolitan's 230 kV transmission system. Metropolitan's CRA system has been incorporated into Edison Company's (Edison) control area in accordance with the Service and Interchange Agreement.

The SWP requires approximately 9,000 GWH to pump 2.3 MAF annually. The California Department of Water Resources (DWR) owns and operates the California Aqueduct. Unlike Metropolitan, DWR only owns and operates the generation required to serve the pumping load. DWR must rely on contractual relationships for its transmission system. DWR has a number of contracts with both the Pacific Gas & Electric Company (PG&E) and Edison. The majority of these contracts terminate in 2004.

Metropolitan owns and operates fifteen (15) small hydroelectric generating units in its distribution system which produced a total of 222 GWH in fiscal year 1994-1995. Currently generation from the Phase I units (Greg Avenue, Lake Mathews, Foothill Feeder, San Dimas, and Yorba Linda) is sold to DWR under an agreement which may terminate no earlier than 2005 or on ten years' advance written notice. Generation from the Phase II units (Sepulveda Canyon, Venice, Temescal, Corona, Perris, Rio Hondo, Coyote Creek, Red Mountain, and Valley View) is sold to the Edison Company under an agreement which may terminate no earlier than 2001 or on five years' advance written notice for termination. Generation from Etiwanda is sold to PG&E under a 20-year agreement that allows for a minimum of three month's notice for termination, provided certain contractual arrangements are met.

Metropolitan's filtration plants required approximately 26 GWH in fiscal year 1994-1995 to process the amount of treated water required for distribution to the member agencies. Power for these facilities is received from three different utilities. The Jensen Filtration Plant is serviced by the Los Angeles Department of Water and Power at a rate of $ 86/megawatt-hour (MWH) or mills/kilowatt-hour. The Mills Filtration Plant receives its electricity from the City of Riverside Public Utilities Department at a rate of $ 95/MWH. The remaining filtration plants, Weymouth, Skinner and Diemer, receive electricity from the Edison Company. The rates for these filtration plants range from $ 85/MWH to $ 90/MWH depending upon the characteristics of the plants. Additionally, the Eastside Reservoir is scheduled to require electricity beginning in August 1998.

California Public Utilities Commission

The CPUC decision rendered on December 20, 1995, outlines a new industry structure for the IOUs in California. Public power utilities may participate in the new structure on a voluntary basis. In the new structure, all transmission of the participating transmission owners will be turned over to an independent system operator (ISO) who will control and operate the transmission system. However, the IOUs and any public power utility who voluntarily decide to join the ISO will retain ownership of their respective transmission lines. Additionally, a power exchange (PX) separate from the ISO and IOUs will be created. The IOUs are required to bid in all of their generation to the power exchange and purchase their power requirements from this exchange. Public power utilities will have the option to join the exchange or negotiate bilateral contracts directly with the generation providers. The decision also allows for full recovery of all stranded investments previously incurred by the utility. A transition charge will be collected through 2004 to compensate the utilities for investments made under previous policies and regulations which are no longer economical in the new industry structure. Of prime interest to Metropolitan is (i) that existing contracts will be honored; and (ii) that direct access is scheduled to begin on January 1, 1998. Direct access will allow the consumer to determine who it will buy generation from and how its load will be served. Metropolitan may use direct access to service the load requirements of the filtration plants and the Eastside Reservoir pumping plant.

The CPUC has developed a roadmap (schedule) which identifies the following issue areas: CEQA, ISO, PX, market power, direct access, consumer safeguards, public purpose, rate setting, rate/product unbundling, performance based rates, and transition costs. For each issue, the CPUC has identified a specific implementation timeline. The first major filing at FERC and CPUC occurred on April 29, 1996 (Filing). This Filing consisted of: a petition for declaratory order; a joint application by the IOU for authorization to convey operational control of designated jurisdictional facilities to the ISO; and a joint IOU application for authority to sell power at market-based rates using a power exchange. The last two documents are intended to establish the ISO and PX, respectively, and give some conceptual understanding of how the two organizations will work. The IOUs intend to make a second filing in early 1997 to provide FERC and the CPUC with sample tariff terms and schedules and other details necessary for a comprehensive understanding of the new industry structure. Work groups have been and will be formed with Stakeholders, including Metropolitan, to address these details. Additionally, Metropolitan will be intervening in the FERC process. Such intervention will allow Metropolitan to be a part of the process and protect its interests.

One of the critical issues for Metropolitan will be its existing contracts which were previously discussed. The IOUs have committed to "honor" existing contracts in the Filing. But the details of how these existing contracts will be honored is unknown at this time. The Filing does not address any specifics, nor does it address any broad concept of how the existing contracts will be honored. Both Metropolitan and DWR have existing contracts which did not require IOU investments in power generation facilities and consequently no stranded costs should be assigned to Metropolitan, either directly or indirectly. Additionally, both agencies should not be responsible for any costs in excess of the embedded costs of providing existing service.

As discussed above, restructuring may also increase the cost of power and therefore the cost of water for Metropolitan. The current total cost of Meeting DWR, CRA and Metropolitan system pumping loads is estimated at $123 million (an average cost of $62/AF). Although estimating the cost of restructuring is difficult as most details have not been developed, a worst case scenario can be estimated based on the total cost of meeting these pumping loads if power were purchased at Edison's system average generation and transmission cost. Under these assumptions, Metropolitan's costs could increase to approximately $410 million ($205/AF).

Metropolitan has also developed an action plan which builds on efforts that staff has already undertaken in various arenas and expands those efforts to cover various other areas of the restructuring process on a pro-active basis with various organizations. The purpose of the action plan is to outline the specific activities that Metropolitan will undertake to first, protect Metropolitan's interests and second take advantage of opportunities to reduce the cost of electricity to Metropolitan's filtration and Eastside Reservoir pumping loads. The plan involves: 1) coordination with DWR to develop an overall strategy for the SWP; 2) briefing of CPUC and FERC regarding the unique circumstances of Metropolitan and DWR; 3) monitoring, reviewing and participating in the many filings which are anticipated to occur on the restructuring at both FERC and the CPUC; 4) brief the California Legislature and the California Congressional Delegation on Metropolitan's uniqueness and the importance of protecting existing contracts; and 5) work with other public agencies and trade organizations to build consensus, establish and

strengthen alliances, and identify divergent interests where they exist. Metropolitan staff is already participating in the California Municipal Utilities Association Restructuring Committee, the energy groups that the Association of California Water Agencies has established, and a Coalition for Comparable Transmission initiated by Southern California Gas Company. A gantt chart showing the major activities and the estimated time line is shown in Attachment I.

Metropolitan's efforts include being actively involved in all phases of the overall restructuring process, and focusing attention towards not inadvertently impacting arrangements already developed by Metropolitan. Metropolitan's ongoing goal is to meet its power requirements for pumping at the lowest possible cost. Attachment II is a discussion paper regarding Managing Risks of Electric Industry Restructuring for Metropolitan.

DAL:jpa

Attachments

derg0596/board

Metropolitan Water District of Southern California
Electric Restructuring Action Plan
Schedule of Activities

1996 Activities	March	April	May	June	July	August	September	October	November	December
Metropolitan's Board/Member Agencies										
Periodic Briefings										
Work Products										
White Paper										
Briefing DC/Sac Reps										
Intervention/Comments										
Department of Water Resources										
Consensus of Contractors										
Develop Strategies										
Coordinate with DWR										
California Public Utilities Commission										
Review Filings/Comment										
Brief CPUC Staff										
Federal Energy Regulatory Commission										
Review/Comment on Open Access										
Review/Comment on CPUC Restrucutring										
California Legislature / U. S. Congress										
Brief Legislators										
Coordinate with Other Entities										
Los Angeles Depart of Water & Power										
Edison										
ACWA, CMUA, APPA										
SWC										
Hoover and Parker Contractors										
Others										

Attachment 1

41908

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

MANAGING RISKS OF ELECTRIC INDUSTRY RESTRUCTURING

Electric industry restructuring is moving forward at a fast pace, and significant changes affecting everyone who uses electricity are on the horizon. The Metropolitan Water District of Southern California pays in excess of $120 million per year for power to pump imported water supplies into the Los Angeles basin, and is seeking to protect its interests and avoid potentially significant increases in power costs. This paper provides a brief background on Metropolitan's power costs, the potential risks, and actions Metropolitan is taking in response to industry restructuring.

RESTRUCTURING IS INEVITABLE

The National Energy Policy Act of 1992 (EPAct) established a mandate to open the nation's transmission grid to encourage wholesale electric competition. In response, the Federal Energy Regulatory Commission established rules for "open access" transmission rates and the recovery of "stranded" or uneconomic utility costs in a final order issued April 24, 1996.

Many states have initiated proceedings to establish retail electric competition. At the center of the ongoing activities is the recent policy decision issued by the California Public Utilities Commission (CPUC). The CPUC regulates retail electric service by California's investor-owned utilities (IOUs). That decision provides the framework under which the IOUs are required to develop comprehensive plans to provide for customer choice and competition in the California electric power industry. Although Metropolitan is not regulated by the CPUC, the policy objectives of the CPUC would transform the industry with significant potential implications for Metropolitan.

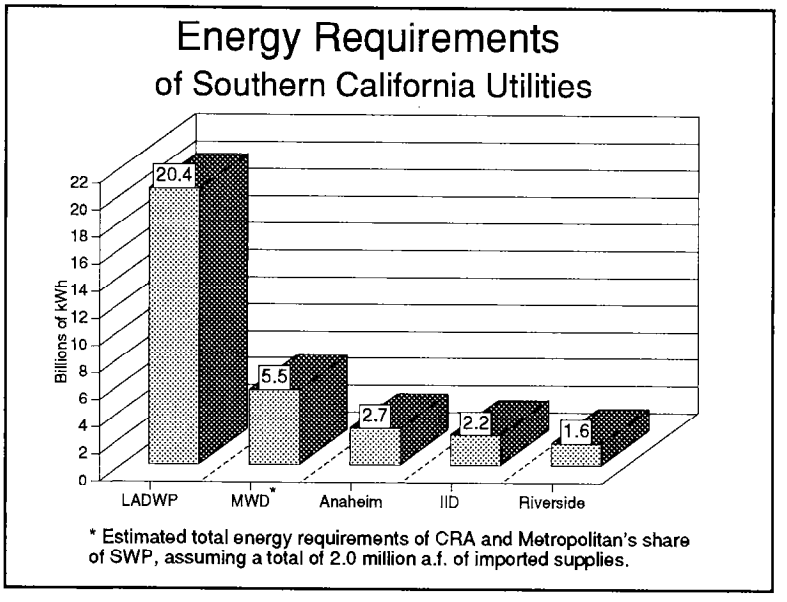
Electric industry restructuring has developed significant momentum, as utilities, customers, regulators and elected representatives recognize that competition may reduce power costs . . . in the long run.

RESTRUCTURING MAY INCREASE POWER COSTS

Utilities have made significant investments in power generation and transmission facilities. The cost of some of these resources is higher than the market price of power, creating "stranded" assets. As power supply, transmission and distribution services are "unbundled" and separately priced, and as the role of state and federal regulators changes to accommodate the new industry structure, costs may be shifted, and the cost of power and transmission service provided under existing contracts may be significantly affected.

METROPOLITAN'S POWER NEEDS ARE SUBSTANTIAL

Metropolitan's imported water supplies include deliveries through the Colorado River Aqueduct, for which Metropolitan arranges power supplies, and the State Water Project (SWP) operated by the California Department of Water Resources (DWR).



Although Metropolitan has no retail electric customers, the total annual energy required to deliver Metropolitan's imported water supplies is greater than the energy served by any municipal electric utility in Southern California except the Los Angeles Department of Water and Power.

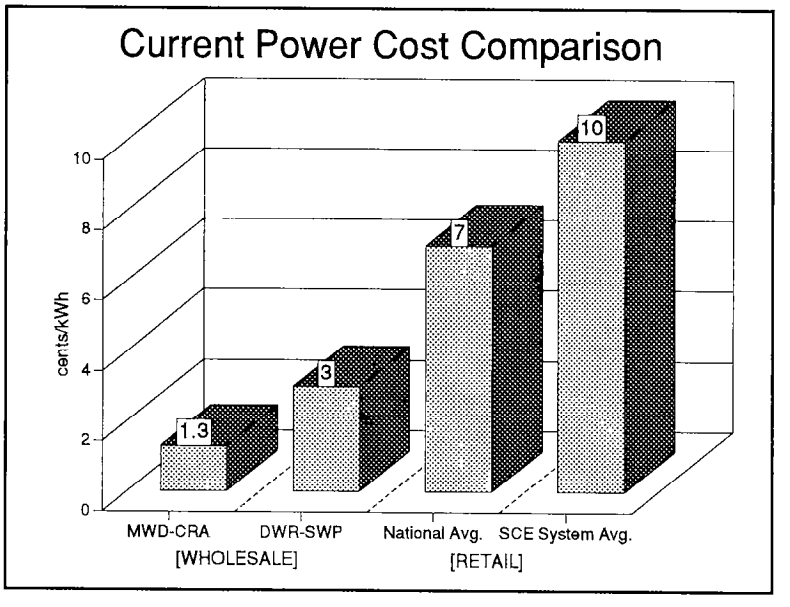
METROPOLITAN HAS ARRANGED FOR VERY LOW COST POWER SUPPLIES

Energy required to pump imported water supplies to the Los Angeles basin is an important element of the cost of the wholesale water supply service Metropolitan provides its member agencies. Both Metropolitan and DWR have procured resources and entered contracts to meet the pumping energy requirements for Metropolitan's wholesale water supplies at the lowest possible cost.

Metropolitan's Colorado River Aqueduct resources include a long-term contract for power from the Boulder Canyon Project at Hoover Dam, and rights into perpetuity to power from the Parker Power Plant downstream of Hoover. The Hoover and Parker resources are integrated through an agreement between Metropolitan and Southern California Edison.

DWR relies on hydroelectric power recovered from the operation of the California Aqueduct, other "off-aqueduct" power supplies, and several transmission and power service agreements.

The power supplies that Metropolitan and DWR have arranged are substantially lower in cost than current retail rates.



RESTRUCTURING INVOLVES RISKS TO METROPOLITAN

These risks include:

- Potential increases in the cost of power presently supplied to Metropolitan under existing wholesale contracts, and direct or indirect assignment of "stranded" generation costs to Metropolitan.

- Potential increases in the cost of transmission service required to assure a reliable, low cost power supply to Metropolitan's Colorado River Aqueduct pumping loads.

- Significant potential impacts on the cost of power and transmission service required by DWR to meet the pumping energy requirements of the State Water Project.

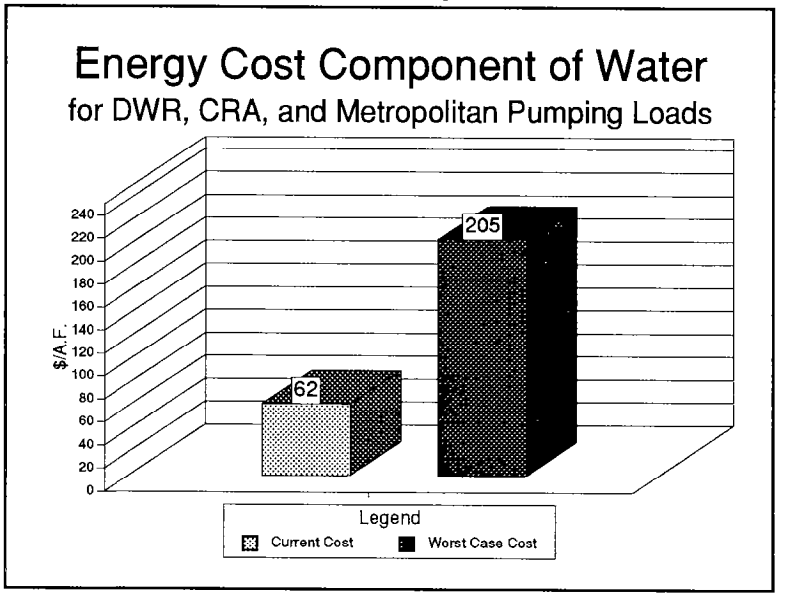
- Recurring proposals to sell federal energy assets at market value, resulting in higher costs of power from Hoover.

- Potential loss of revenue if contracts for the sale of power from Metropolitan's small hydroelectric facilities on its distribution system are terminated.

- Possible state legislation to regulate Metropolitan or otherwise limit Metropolitan's options.

RESTRUCTURING RISKS MAY INCREASE THE COST OF WATER

Metropolitan is responsible for providing safe, reliable water supplies to Southern California, and although Metropolitan has no retail electric customers, any increase in power costs to Metropolitan will ultimately be borne by the retail water customers of Metropolitan's member agencies. These customers must be protected from any inequitable cost increases which may result from industry restructuring.



Based on approximate power costs and water deliveries, the current total cost of meeting DWR, CRA, and Metropolitan system pumping loads is estimated at $123 million (an average cost of $62 per a.f.).

The potential cost to Metropolitan of restructuring is difficult to estimate, as most details of restructuring have not yet been developed. A worst case scenario can be estimated based on the total cost of meeting these pumping loads if power were purchased at Southern California Edison's

system average generation and transmission cost. Under this assumption, Metropolitan's cost could increase to approximately $410 million ($205 per a.f.), representing a cost increase of $287 million ($143 per a.f.).

METROPOLITAN'S POSITION ON RESTRUCTURING

- Metropolitan and DWR have each procured resources and negotiated wholesale power contracts to meet pumping power requirements. No investor-owned utility investments in power generation facilities have been made to serve DWR or Metropolitan's CRA loads and no stranded costs should be assigned to Metropolitan, either directly or indirectly.

- Metropolitan and DWR should not be responsible for any costs in excess of the embedded cost of providing service under existing wholesale contracts.

- Existing contractual rights to power supplies and firm transmission service necessary to meet DWR and Metropolitan pumping requirements should not be limited, nor should the cost of that service increase as a result of restructuring.

METROPOLITAN IS TAKING ACTION

Among the activities that Metropolitan is undertaking to protect its interests are the following:

- Participate in CPUC, FERC, and legislative proceedings to protect Metropolitan's interests.

- Obtain recognition of the unique position of Metropolitan and DWR in all forums.

- Quantify the potential opportunities and costs to Metropolitan and DWR from restructuring, and evaluate long term resource alternatives recognizing the risks and uncertainties of restructuring.

- Actively oppose proposals to sell Hoover and Parker resources through an auction, and pursue "defederalization" by transfer of the Hoover and Parker resources to the existing contractors.