

- **Board of Directors**
Water Planning, Quality and Resources Committee

December 14, 2004 Board Meeting

9-4

Subject

Authorize inclusion of rate structure integrity language in future water management program incentive agreements

Description

Board approval is requested to include rate structure integrity language in all future Local Resources, Seawater Desalination and Conservation program incentive agreements, and in all existing Local Resources Program (LRP) agreements that were approved by the Board subject to negotiating the rate structure integrity language. The purpose of this action is to assure funding for Metropolitan's long-term incentive programs.

Metropolitan's rate structure was developed in collaboration with the member agencies and extensive public input. The established and preferred approach to initiate and implement changes to that rate structure is through Metropolitan's existing board and member agency processes. Revenues produced from Metropolitan's rates help fund local projects and conservation programs, which are implemented to meet the Integrated Resources Plan (IRP) water supply reliability goals and local supply requirements. Legal and legislative challenges to Metropolitan's rate structure outside of established public board processes could have an adverse impact on Metropolitan's ability to sustain project and program funding and are disruptive and costly. In fiscal year 2004/05, Metropolitan expects to provide \$41 million in incentives, with that amount projected to increase to \$95 million by 2015 as projects under development mature.

To ensure funding stability, staff recommends that proposed rate structure integrity provisions (**Attachment 1**) be included in all future Local Resources, Seawater Desalination and Conservation program agreements, and in all existing LRP agreements that were approved subject to negotiating the rate structure integrity language. The language provides that funding agreements could terminate (upon board action) if recipients of Metropolitan funds challenge Metropolitan's existing rate structure via the courts or legislature. Further, the language offers mediation as an alternative prior to any action by the Chief Executive Officer and the Board. This language does not prohibit agencies from litigating or legislating changes. It is hoped that this language would help encourage member agencies and other funding recipients to continue to work within the collaborative and public board process to develop consensus-based changes to the rate structure, rather than initiate divisive and costly litigation or legislative battles. Member agencies and their agencies would retain the ability to challenge a revised future Metropolitan rate structure in the event that future boards or legislation modifies the rate structure.

The attached language (**Attachment 1**), which corresponds to Option #1 of this letter, would help ensure a stable revenue stream for development of vital local projects and conservation programs to meet IRP resource targets, and reduce the potential for litigation. Another proposed option (**Attachment 2**), which corresponds to Option #2 of this letter, would call for disputes to be mediated by a third party before proceeding with litigation or legislative alternatives. However, mediation would not be binding and regardless of the result, Metropolitan would not have the ability to halt payments under the agreement. The rate structure integrity provisions have been discussed with member agency managers over the past year. Some support the concept while others do not. Several agencies have sent a letter requesting a deferral of action pending further study, which is the basis for Option #3 (**Attachment 3**).

Policy

By Minute Item 43021, dated June 9, 1998, board adoption of the Local Resources Program

California Environmental Quality Act (CEQA)

CEQA determination for Option #1 and Option #2:

The proposed action is not defined as a project under CEQA because it involves continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed action is not subject to CEQA because it involves 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). Prior to Metropolitan taking action on future agreements of this nature, Lead Agencies for the projects will comply with CEQA and the State CEQA Guidelines. As the Responsible Agency, Metropolitan's Board will then review and consider the CEQA documentation before taking further action.

The CEQA determination is: Determine that the proposed action is not subject to CEQA pursuant to Sections 15378(b)(2) and 15378(b)(4) of the State CEQA Guidelines.

CEQA determination for Option #3 and Option #4:

None required

Board Options/Fiscal Impacts

Option #1

Adopt the CEQA determination and authorize inclusion of rate structure integrity language, as specified in [Attachment 1](#), in all future Local Resources, Seawater Desalination and Conservation programs, and in all existing LRP agreements that were approved subject to negotiating the rate structure integrity language.

Fiscal Impact: No current impact. Modification in cost-of-service methodology and rate structure elements could result in changes in cost responsibilities among member agencies.

Option #2

Adopt the CEQA determination and authorize inclusion of rate structure integrity language deleting Metropolitan's right to terminate the agreement upon legal or legislative challenge, but require mediation and non-binding findings by the mediator prior to litigation or legislative challenge, as specified in [Attachment 2](#), in all future Local Resources, Seawater Desalination and Conservation programs.

Fiscal Impact: No current impact. Modification in cost-of-service methodology and rate structure elements could result in changes in cost responsibilities among member agencies.

Option #3

Defer action until the member agency proposal on rate structure integrity language is completed in March 2005.

Fiscal Impact: No current impact. Modification in cost-of-service methodology and rate structure elements could result in changes in cost responsibilities among member agencies.

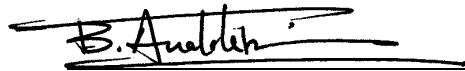

Option #4

Do not authorize inclusion of rate structure integrity language in any Local Resources, Seawater Desalination or Conservation programs.

Fiscal Impact: No current impact. Modification in cost-of-service methodology and rate structure elements could result in changes in cost responsibilities among member agencies.

Staff Recommendation

Option #1

	12/2/2004
<u>B. Anatole Falagan</u> for Stephen N. Arakawa Manager, Water Resource Management	<u>Date</u>
	12/2/2004
<u>Ronald R. Gastelum</u> Chief Executive Officer	<u>Date</u>

Attachment 1 – Option #1 Rate Structure Integrity Provisions

Attachment 2 – Option #2 Rate Structure Integrity Provisions

Attachment 3 – November 18, 2004 Letter to Ron Gastelum

BLA #3313

Option #1

Rate Structure Integrity Provisions

1. **[Recipient]** and **[Member Agency]** if different than **Recipient** agree and understand that Metropolitan's rate structure as of January 1, 2004 ("Existing Rate Structure") provides the revenue necessary to support the development of new water supplies by local agencies through incentive payments in the Local Resources Program (LRP), Conservation Credits Program (CCP), and the Seawater Desalination Program (SDP). In particular, the Water Stewardship Rate is the component of Existing Rate Structure that provides revenue for the LRP, CCP and SDP. Further, **[Recipient]** and **[Member Agency]** acknowledge that Existing Rate Structure and all components within that rate structure were developed with extensive public input and member agency participation, and that the elements of Existing Rate Structure have been properly adopted in accordance with Metropolitan's rules and regulations.
2. (a) **[Recipient]** and **[Member Agency]** agree that Metropolitan's rates set under the Existing Rate Structure may be reset throughout the term of this Agreement to account for the cost of service, and that **[Recipient]** and **[Member Agency]** will address any and all future issues, concerns and disputes relating to Existing Rate Structure, through administrative opportunities available to them pursuant to Metropolitan's public board process. As such, **[Recipient]** and **[Member Agency]** agree if they file or participate in litigation or support legislation to challenge or modify Existing Rate Structure, including changes in overall rates and charges that are consistent with the current cost-of-service methodology, Metropolitan may initiate termination of this agreement consistent with Paragraph 4 below. Metropolitan agrees that any change in Existing Rate Structure, including changes in cost-of-service philosophy or methodology would be enacted only after collaboration and discussion with its member public agencies, and Metropolitan's public board review and approval process.

(b) Notwithstanding the foregoing, **[Recipient]** and **[Member Agency]** retain the right to file and/or participate in litigation and/or to support legislation without triggering the termination of this agreement if there are material changes to Existing Rate Structure or changes in cost-of-service methodology used to set rates by future Metropolitan board action. **[Recipient]** and **[Member Agency]** also retain the right to file and/or support litigation should Metropolitan, in setting rates under Existing Rate Structure, fail to comply with public notice, open meeting, or other legal requirements associated with the process of setting water rates and related taxes, fees, and charges. **[Recipient]** and **[Member Agency]** agree that they will not file or participate in litigation, nor will they support legislation affecting Metropolitan's rate structure after any such change in rate structure or violation of the law regarding rate setting processes until, and unless, they have exhausted all administrative opportunities available to them pursuant to Metropolitan's public board process.
3. **[Recipient]** and **[Member Agency]** agree that all users of the Metropolitan conveyance and distribution system should support the LRP, CCP, and SDP, that such projects provide benefits to Metropolitan and the users of the system by making existing distribution and conveyance capacity available for additional delivery, and that under Existing Rate Structure, the Water Stewardship Rate is an element of charges properly adopted by the Metropolitan Board and properly applied to water wheeled through the Metropolitan conveyance and distribution system.
4. Should **[Recipient]** or **[Member Agency]** file or support litigation, or sponsor or support legislation, that would challenge or be adverse to Existing Rate Structure, as described in Paragraph (a) of Section 2, Metropolitan's Chief Executive Officer may file a 90-day notice of intent to terminate this Agreement with Metropolitan's Executive Secretary, with copies to all members of Metropolitan's

Board of Directors, and contemporaneously provide **[Recipient]** and **[Member Agency]** with a copy of the notice. Within 30 days of receipt of such notice, **[Recipient]** and **[Member Agency]** shall have the right to request, in writing, mediation of the dispute by a neutral third party with expertise in finance and rate setting. The mediator shall be selected by agreement of the parties, or failing agreement within 60 days of such request for mediation, a mediator shall be selected by the Metropolitan Board of Directors from a list of at least four candidates, one each from **[Recipient]** and **[Member Agency]**, and two of which will be supplied by Metropolitan's Chief Executive Officer. The cost of the mediation shall be borne equally by the parties. The request for mediation shall also serve to stay the 90-day notice of intent to terminate, but for no more than 90 days beyond the filing of the notice of request for mediation, unless otherwise agreed in writing by the parties. If mediation does not result in an agreement acceptable to each party to this Agreement within the time provided herein, the notice of intent to terminate shall be reinstated. The Metropolitan Board of Directors shall act to approve or disapprove termination of this Agreement, and all of Metropolitan's obligations hereunder shall terminate if approved, on or before the ninetieth day following filing of the notice to terminate or, if mediation has been requested as described above, the ninetieth day following the request for mediation (or other date agreed in writing by the parties.)

5. Metropolitan and **[Recipient]** and **[Member Agency]** agree that should litigation or legislation brought forth or sponsored by third parties result in changes to Existing Rate Structure, this Agreement will continue in effect unless mutually agreed in writing by the parties.
6. Should Metropolitan and its member agencies agree on an alternative rate and revenue structure that obviates the need for this section on Rate Structure Integrity, this section shall be amended or deleted to conform to such action.
7. Notwithstanding the foregoing, Metropolitan shall have no power or authority under this Section to terminate this Agreement, and Metropolitan's Chief Executive Office shall not file a 90-day notice of intent to terminate this Agreement, if a **[Member Agency]** (but not the **[Recipient]**) files or participates in any litigation or supporting legislation to challenge or modify Existing Rate Structure, but the **[Recipient]** transmits a writing to Metropolitan's Chief Executive Officer within thirty (30) days of request therefore from Metropolitan, stating that **[Recipient]** has not participated directly or indirectly in the filing or prosecution of any litigation or the drafting or advocacy of any legislation to challenge or modify Existing Rate Structure, and indicates support for Existing Rate Structure.

Note: **[Recipient]** refers to project owner.

Option #2

Rate Structure Integrity Provisions

1. **[Recipient]** and **[Member Agency]** if different than **Recipient** agree and understand that Metropolitan's rate structure as of January 1, 2004 ("Existing Rate Structure") provides the revenue necessary to support the development of new water supplies by local agencies through incentive payments in the Local Resources Program (LRP), Conservation Credits Program (CCP), and the Seawater Desalination Program (SDP). In particular, the Water Stewardship Rate is the component of Existing Rate Structure that provides revenue for the LRP, CCP and SDP. Further, **[Recipient]** and **[Member Agency]** acknowledge that Existing Rate Structure and all components within that rate structure were developed with extensive public input and member agency participation, and that the elements of Existing Rate Structure have been properly adopted in accordance with Metropolitan's rules and regulations.
2. (a) **[Recipient]** and **[Member Agency]** agree that Metropolitan's rates set under the Existing Rate Structure may be reset throughout the term of this Agreement to account for the cost of service, and that **[Recipient]** and **[Member Agency]** will address any and all future issues, concerns and disputes relating to Existing Rate Structure, through administrative opportunities available to them pursuant to Metropolitan's public board process. Metropolitan agrees that any change in Existing Rate Structure, including changes in cost-of-service philosophy or methodology would be enacted only after collaboration and discussion with its member public agencies, and Metropolitan's public board review and approval process.

(b) Notwithstanding the foregoing, **[Recipient]** and **[Member Agency]** retain the right to file and/or participate in litigation and/or to support legislation if there are material changes to Existing Rate Structure or changes in cost-of-service methodology used to set rates by future Metropolitan board action. **[Recipient]** and **[Member Agency]** also retain the right to file and/or support litigation should Metropolitan, in setting rates under Existing Rate Structure, fail to comply with public notice, open meeting, or other legal requirements associated with the process of setting water rates and related taxes, fees, and charges.
3. **[Recipient]** and **[Member Agency]** agree that all users of the Metropolitan conveyance and distribution system should support the LRP, CCP, and SDP, that such projects provide benefits to Metropolitan and the users of the system by making existing distribution and conveyance capacity available for additional delivery, and that under Existing Rate Structure, the Water Stewardship Rate is an element of charges properly adopted by the Metropolitan Board and properly applied to water wheeled through the Metropolitan conveyance and distribution system.
4. Should **[Recipient]** or **[Member Agency]** file or support litigation, or sponsor or support legislation, that would challenge or be adverse to Existing Rate Structure, as described in paragraph (a) of Section 2, Metropolitan's Chief Executive Officer may file a 90-day notice of intent to implement mandatory mediation with Metropolitan's Executive Secretary, with copies to all members of Metropolitan's Board of Directors, and contemporaneously provide **[Recipient]** and **[Member Agency]** with a copy of the notice. Mediation shall be by a neutral third party with expertise in finance and rate setting. The mediator shall be selected by agreement of the parties, or failing agreement within 60 days of such request for mediation, a mediator shall be selected by the Metropolitan Board of Directors from a list of at least four candidates, one each from **[Recipient]** and **[Member Agency]**, and two of which will be supplied by Metropolitan's Chief Executive Officer.

The costs of the mediation shall be borne equally by the parties. If mediation does not result in an agreement acceptable to each party to this Agreement within the time provided herein, the legal or legislative action shall be reinstated. The Metropolitan Board of Directors shall act subsequent to protect Metropolitan's interest in any manner they see fit.

5. Metropolitan and [**Recipient**] and [**Member Agency**] agree that should litigation or legislation brought forth or sponsored by third parties result in changes to Existing Rate Structure, this Agreement will continue in effect unless mutually agreed in writing by the parties
6. Should Metropolitan and its member agencies agree on an alternative rate and revenue structure that obviates the need for this section on Rate Structure Integrity, this section shall be amended or deleted to conform to such action.

November 18, 2004

Mr. Ronald Gastelum
Metropolitan Water District
of Southern California
P O Box 54153
Los Angeles, CA 90054

Dear Mr. Gastelum,

Over the last several months, many member agencies of the Metropolitan Water District of Southern California (MWD) have described concerns relative to what has been termed "Rate Structure Integrity" language. MWD staff has proposed that MWD include language in all future local resources, seawater desalination and conservation incentive contracts with member agencies prohibiting grant recipients from "deliberately engage(ing) in actions outside of Metropolitan Board proceedings that would jeopardize Metropolitan's rate structure."

At the October Member Agencies Managers meeting, you indicated your desire to take the issue to the Board. A discussion ensued with the managers regarding their agencies perspectives on the issue. You then asked whether other concepts could be developed and put on the table as an alternative to the MWD staff proposal.

A group of Member Agency managers held a meeting on November 15th at Western Municipal Water District's office to discuss developing a proposal for consideration at the November 19th general managers meeting. The individuals present represented Calleguas Municipal Water District, Central and West Basin Municipal Water Districts, City of Los Angeles, Municipal Water District of Orange County, Western Municipal Water District, San Diego County Water Authority, and Upper San Gabriel Valley Municipal Water District.

Various concepts were discussed including:

- Relationship of proposed Section 7 language to possible threats to rate structure integrity
 - Does the language really protect the rate structure?
 - Does the language affect only a small number of agencies (e.g., only those signing agreements)?
 - How are the remaining agencies to be included?
 - How can the rate structure be supported?

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- Methods to protect the water stewardship revenues and consideration of setting up a separate fund for this revenue source
- Developing opportunities to provide more two-way communication at Member Agency Manager's meetings.
 - Possibility of having more input on agenda setting
 - Consider breaking out more technical aspects to another meeting. More focus on policy issues
 - Spend more time considering future Board agenda items
- Enhancing opportunities to resolve concerns and issues within the MWD structure
 - Make sure all member agencies have a method to bring issues of concern to the MWD Board
 - Consider timeliness of staff reports and information relative to Board agendas
 - Develop more communication opportunities for member agencies
 - Develop a means to have member agencies use a MWD process to resolve issues, before going elsewhere

The group discussed the need for a consensus-based proposal dealing with the issues outlined. The feeling of the majority of the members present was that the staff-proposed language has not taken into consideration all of these issues.

All agreed that more time should be allowed for the agencies to develop the alternative processes and proposal. In the spirit of collaboration and cooperation among the member agencies and with MWD, we would like to continue our dialog regarding the issues that led to the MWD staff proposal and propose an alternative way to accomplish the stated objective. We therefore request that the MWD staff proposal not be brought to the Board at this time, in order to give the member agencies a chance to continue develop an alternative. We are committing to complete this by the March Member Agency Managers' meeting for Board action in April.



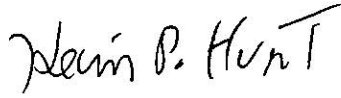
Eastern Municipal Water District



Inland Empire Utilities Agency

Signatures continue on Page 3

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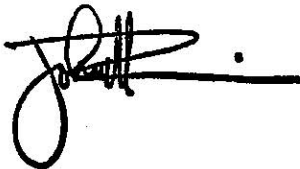
Municipal Water District of Orange County



San Diego County Water Authority



Upper San Gabriel Valley Municipal Water District



Western Municipal Water District

JVR:sg