

- **Board of Directors**  
**Budget, Finance, Investment and Insurance Committee**

September 12, 2006 Board Meeting

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**9-3**

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**Subject**

Preliminary analysis of State Water Project calendar year 2007 Statement of Charges

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**Description**

Metropolitan has received the calendar year 2007 Statement of Charges (SOC) for its participation in the State Water Project. Staff is reviewing the SOC with the California Department of Water Resources to ensure compliance with the contracts and will report its findings to the Board in December 2006. Because the State Water Project provides Metropolitan more than half of its imported water supply and contributes to over 20 percent of its annual budget, staff continues to implement specific measures to ensure that Metropolitan receives maximum return on its SWP investments and that the DWR invoices are accurate. One aspect of these measures is a review and audit of the SOC.

The 2007 charge total is \$565 million, which is \$59 million more than the 2006 charge. A comparison of CY 2006 and 2007 charges is detailed in [Attachment 1](#).

**Preliminary Analysis of CY 2007 Statement of Charges**

The SOC is a declaration, provided in advance, of maximum SWP charges provided to each contractor. The charges are derived from estimates made by DWR for the upcoming year. Because DWR issues invoices based on its estimates, corrections for over- or under-payments are made in subsequent years after actual costs are determined. DWR applies conservatively high estimates to create the SOC because it has limited contractual authority to increase charges during the course of the year if higher costs are encountered. In addition, the SOC includes the annual collection of bond cover for the SWP revenue bonds. This bond cover is routinely returned to the contractors in the subsequent year but this return is not reflected in the SOC. As a result of these factors, Metropolitan's actual expenditures are normally lower than the SOC amount.

Comparisons with last year's charges are as follows:

- \$52.5 million increase in Power (variable and off aqueduct) charges. This increase reflects a combination of factors including changes in energy rates, transmission costs and water deliveries used to calculate the charge. During the year, Metropolitan, other contractors and DWR staff cooperatively assess if SWP water deliveries, energy market rates, or variable transmission costs are significantly less than incorporated into the SOC. When such a determination is made, the energy cost actually invoiced to the contractors is reduced. Staff continues to work with DWR to develop short- and long-term means to improve the management of SWP energy costs.
- \$2 million decrease in the Minimum Operation, Maintenance, Power & Replacement (OMP&R) charges. Each year's SOC includes an estimate for the year's operating cost and a catch up adjustment for prior years' over- or under-collection. In recent years, Metropolitan's catch up adjustment has partially offset actual costs. This year's decrease in OMP&R charges is due mainly to a reduction in the Delta minimum charge, which relates to the mostly fixed costs of water supply development. With increased demands for water by all of the contractors and an aging SWP infrastructure, Metropolitan is working closely with DWR to ensure that critical pumps, generators and other facilities are maintained to be available when needed to move our water.

- \$8.5 million increase in Capital. The increase is attributable to reduced Monterey Amendment Rate Reduction Rebates and initial engineering studies for the East Branch Aqueduct Enlargement. Metropolitan is working with a group of stakeholder contractors and DWR to efficiently expand the East Branch Aqueduct's capacity to meet our growing needs. The East Branch Aqueduct conveys water to our Inland Feeder and the Santa Ana Valley Pipeline.

### **Relationship of Statement of Charges to Metropolitan Budget**

Metropolitan and DWR prepare their annual budget using different accounting and reporting methods. DWR uses the calendar year accrual approach for the SOC, while Metropolitan budget uses the cash basis fiscal year approach. Metropolitan's current fiscal year SWP budget for capital, maintenance, and off-aqueduct power facilities is largely based on the SOC received last July and DWR's annual long-range cost estimates.

A significant difference between Metropolitan projected budget and DWR SOC is the methodology used for estimating power costs. DWR's estimate for power is based on maximum expected costs because the water supply contracts limit DWR's ability to increase the power price above the initial SOC estimate. The contracts do, however, allow reductions. DWR prepares the initial power price in the SOC with the expectation that the actual invoice price will be lowered during the year. Metropolitan's budgeting technique is based on our projection of the most probable power cost. The most probable power cost is based on our projected water needs and estimate of SWP's net cost of buying and selling electrical energy. Metropolitan's budget also includes allowances for expected credits that are not part of the SOC.

### **Improved Cost Management Practices**

A number of activities were undertaken in 2006 to control cost and improve value. For example, as a response to Metropolitan's and other State Water Contractors' requests for effective control of energy cost, DWR is initiating a second stage of gas hedging to reduce spikes in electrical energy costs. DWR is also allocating some of its staff and consultant resources to develop long-term energy planning.

### **Protest of 2006 Statement of Charges**

Metropolitan formally protested inaccuracies in last year's SOC. DWR and Metropolitan management and staff are currently working cooperatively to resolve as many of the protested invoice issues as possible through an administrative process instead of litigation.

### **Future Steps**

Richardson and Company, Metropolitan's independent auditor, commenced a review of the CY 2007 SOC to ensure that the DWR billings are correct. Metropolitan is also working with the other contractors and DWR to further analyze project cost accuracy. Staff will take appropriate action to cause DWR to correct any errors, including possible filing of claims with the State Victim Compensation and Government Claims Board. In the upcoming months, staff will present the results of the independent audit, and request the Board to consider authorizing the General Manager to make SWP payments beginning in January 2007. Additionally, staff may also seek authorization to exercise an existing agreement allowing Metropolitan to recall up to 100,000 acre-feet from the Desert Water Agency and Coachella Valley Water District and to reimburse them for the associated costs. Future hydrologic condition will influence the decision to make the recall. Staff will report changes, if any are made by DWR, to the Statement of Charges in December 2006.

### **Policy**

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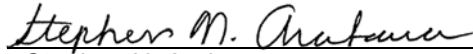
Each year, the Board considers authorizing the General Manager to make payments for the CY charges under Metropolitan's SWP contracts.

By Minute Item 20862, dated Oct. 4, 1960, the Board authorized Metropolitan to enter into the State Water Project contract, which commits Metropolitan to pay for costs associated with the SWP.

**Fiscal Impact**

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Staff is currently assessing the impact of the SWP charges on the FY 2006/07 budget and future revenue requirements.

  
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Stephen N. Arakawa  
Manager, Water Resource Management

8/17/2006  
Date

  
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Jeffrey Kightlinger  
General Manager

8/23/2006  
Date

**Attachment 1 – Comparison of Metropolitan’s Statement of Charges for CY 2006 and CY 2007**

BLA #4683

<b>Comparison of Metropolitan's Statement of Charges for CY 2006 and CY 2007</b>			
(\$ millions)			
	<b>CY 2006 SOC</b>	<b>CY 2007 SOC</b>	<b>Change*</b>
<b>Total Power</b>	\$ 259	\$ 312	53
<b>Total Min OMP&amp;R</b>	108	106	(2)
<b>Total Capital</b>	139	147	8
<b>Total SWP Charges</b>	<b>\$ 506</b>	<b>\$ 565</b>	<b>59</b>
<b>Table A Water AF</b>	<b>1,911,500</b>	<b>1,911,500</b>	

\* Increase (Decrease)