

- **Board of Directors**  
**Business and Finance Committee**

March 11, 2008 Board Meeting

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8-2

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**Subject**

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Adopt (1) recommended water rates and charges; and (2) resolutions to impose charges, for fiscal year 2008/09

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**Description**

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Background

This letter recommends approval of: (1) the recommended rates and charges effective January 1, 2009, as discussed in this letter; (2) the resolution to impose the Readiness-to-Serve Charge effective January 1, 2009; and (3) the resolution to impose the Capacity Charge effective January 1, 2009.

Metropolitan Water District Administrative Code Section 4304 requires the General Manager to present recommendations for water rates and charges for the next fiscal year based on the Business and Finance Committee's determination of required water revenues. On January 8, 2008, the Committee determined that the water revenue requirement should not be less than \$1.32 billion, and approved resolutions of intent to levy the Readiness-to-Serve Charge and Capacity Charge. In addition, the Committee set a time for a public hearing on the recommended rates and charges. On February 11, 2008, a public hearing was held before the Business and Finance Committee. Public comments are included in [Attachment 1](#) for the Board's consideration.

Recommended Rates and Charges

The cost-of-service analysis supporting the recommended rates and charges is included as [Attachment 2](#). The cost of service analysis, "Metropolitan Water District of Southern California, fiscal year 2008/09 Cost of Service," is consistent with the cost-of-service process approved by the Board in 2003. The General Manager's recommendation for water rates and charges is shown in Table 1, "Recommended Rates and Charges." The estimated overall increase in rates and charges revenue under option 1 will be 9.8 percent plus a \$25 per acre-foot Water Supply Surcharge, if these rates and charges are adopted. As shown in Table 1, this involves increasing the Tier 1 Supply rate by \$36 per acre-foot, the Tier 2 Supply rate by \$79 per acre-foot, and the Treatment Surcharge by \$10 per acre-foot. The RTS charge would also increase by \$10 million. A Water Supply Surcharge of \$25 per acre-foot would be assessed to all water deliveries other than Tier 2 sales and Replenishment sales. This surcharge will help fund the purchase of additional transfer supplies to meet firm and agricultural demands. Replenishment deliveries have been suspended since May of 2007 and are expected to remain suspended through fiscal year 2008/09. In the event that surplus supplies become available, allowing Metropolitan to make replenishment deliveries, the Water Supply Surcharge would not be applied to Replenishment purchases.

The recommended rates and charges were determined based on a total revenue requirement of \$1.32 billion for fiscal year 2008/09. The existing rates, which are effective through December 31, 2008, and the recommended rates, which will be effective January 1, 2009, are estimated to generate total revenue of \$1.142 billion in fiscal year 2008/09. This assumes total sales of 2.23 million acre-feet during fiscal year 2008/09. As detailed in [Attachment 2](#) – Fiscal Year 2008/09 Cost of Service, these rates and charges do not fully recover costs during fiscal year 2008/09 or over calendar year 2009. In order to mitigate increases in 2009, as much as \$182 million from the Water Rate Stabilization Fund and Water Stewardship Fund would be utilized to meet obligations during fiscal year 2008/09. This level of withdrawals reflects funding \$95 million of Replacement and Refurbishment expenditures (R&R) as discussed in January and included in the \$1.32 billion revenue requirement.

In order to reduce draws from reserves to help mitigate risks that could occur in the coming year, the proposed 2008/09 budget includes capital financing of \$30 million from revenues (PAYG), given the assumption of

2.23 million acre-feet of sales. The rates and charges and the cost-of-service model are based on maintaining PAYG at \$95 million. But, it is appropriate to preserve liquidity by reducing the PAYG financing target to \$30 million in the 2008/09 budget. If Metropolitan’s financial condition improves because of higher sales (greater than 2.23 million acre-feet) or lower operating costs or water supply costs, staff will provide options for the Board’s consideration regarding increasing PAYG amounts in the upcoming fiscal year. In addition to reducing PAYG funding in 2008/09, staff recommends that PAYG be restored to \$95 million in the subsequent two years, and increased to \$125 million beginning in fiscal year 2011/12 to make up for the reductions in fiscal years 2007/08 and 2008/09.

**Table 1. Recommended Rates and Charges**

	Effective January 1, 2008	Option 1 January 1, 2009	Option 2 January 1, 2009	Option 3 January 1, 2009
Tier 1 Supply Rate (\$/AF)	\$73	\$109	\$109	\$128
Tier 2 Supply Rate (\$/AF)	\$171	\$250	\$250	\$250
Water Supply Surcharge (\$/AF)	-	\$25	-	-
System Access Rate (\$/AF)	\$143	\$143	\$143	\$155
Water Stewardship Rate (\$/AF)	\$25	\$25	\$25	\$32
System Power Rate (\$/AF)	\$110	\$110	\$110	\$116
Full Service Untreated Volumetric Cost (\$/AF)				
Tier 1	\$351	\$412	\$387	\$431
Tier 2	\$449	\$528	\$528	\$553
Replenishment Water Rate Untreated (\$/AF)	\$258	\$294	\$294	\$338
Interim Agricultural Water Program Untreated (\$/AF)	\$261	\$322	\$297	\$341
Treatment Surcharge (\$/AF)	\$157	\$167	\$167	\$177
Full Service Treated Volumetric Cost (\$/AF)				
Tier 1	\$508	\$579	\$554	\$608
Tier 2	\$606	\$695	\$695	\$730
Treated Replenishment Water Rate (\$/AF)	\$390	\$436	\$436	\$490
Treated Interim Agricultural Water Program (\$/AF)	\$394	\$465	\$440	\$494
Readiness-to-Serve Charge (\$M)	\$82	\$92	\$92	\$100
Capacity Charge (\$/cfs)	\$6,800	\$6,800	\$6,800	\$6,800

Description of rates and charges

- a. **Tier 1 Supply Rate.** It is recommended that the Tier 1 Supply Rate increase by \$36 to \$109 per acre-foot. This increase is necessary due to the additional 200 thousand acre-feet of water transfers that Metropolitan has to procure. The Tier 1 Supply Rate recovers Metropolitan’s supply costs that are not recovered by sales at the Tier 2 Supply Rate and a portion of the long-term storage and agricultural water sales. The Tier 1 Supply Rate will be charged on a dollar per acre-foot basis for system supply delivered to meet firm demands that are less than the Tier 1 Annual Limit as shown in Schedule 12, **Attachment 2**.
- b. **Tier 2 Supply Rate.** The Tier 2 Supply Rate is set at a level that reflects Metropolitan’s cost of developing supplies. It is recommended that the Tier 2 Supply Rate increase by \$79 to \$250 per

acre-foot. This rate reflects the cost Metropolitan would pay for the additional water transfers in fiscal year 2008/09. The Tier 2 Supply Rate will be charged on a dollar-per-acre-foot basis for system supply delivered to meet firm demands that are greater than the Tier 1 Annual Limit. This increase will not result in any additional revenue until fiscal year 2009/10.

- c. **System Access Rate.** It is recommended that the System Access Rate remain at \$143 per acre-foot. The System Access Rate recovers a portion of the costs associated with the conveyance and distribution system, including capital and operations and maintenance costs. All users (including member agencies and third-party wheeling entities) of the Metropolitan system pay the System Access Rate.
- d. **Water Supply Surcharge.** Due to the need to acquire 200,000 acre-feet of additional spot market water transfers as a result of the pumping restrictions in the Delta, it is recommended that Metropolitan include a Water Supply Surcharge of \$25 per acre-foot to fund these purchases. The Water Supply surcharge would be added to all Tier 1 sales, as well as included as part of the cost of water purchased under the Interim Agricultural Water Program. This surcharge would generate about \$50 million in 2009, which is equal to the cost of acquiring these transfers at the anticipated cost of \$250 per acre-foot. The need for the Water Supply Surcharge will be evaluated annually, but it is anticipated that the surcharge would be in place for at least two years – or until a near-term Delta solution is realized, resulting in increased SWP deliveries, or longer term water transfers have been executed, providing additional water supplies for future years.
- e. **Water Stewardship Rate.** It is recommended that the Water Stewardship Rate remain at \$25 per acre-foot. The Water Stewardship Rate will be charged on a dollar-per-acre-foot basis to collect revenues to support Metropolitan's financial commitment to conservation, water recycling, groundwater recovery and other demand management programs approved by the Board. The Water Stewardship Rate is charged for every acre-foot of water conveyed by Metropolitan, and is used to fund Metropolitan's commitment to local resources investments in fiscal year 2008/09 including the departmental costs of administering the demand management programs. It is estimated that approximately \$15 million will be withdrawn from the Water Stewardship Fund to meet costs associated with these programs in fiscal year 2008/09.
- f. **System Power Rate.** It is recommended that the System Power Rate remain at \$110 per acre-foot. The System Power Rate will be charged on a dollar-per-acre-foot basis to recover the cost of power necessary to pump water from the State Water Project and Colorado River through the conveyance system. The System Power Rate will be charged for all Metropolitan supplies.
- g. **Treatment Surcharge.** The Treatment Surcharge recovers the cost of providing treated water service, including allocated capital financing costs and operations and maintenance cost. Board action in March 2005 reduced the treatment surcharge increase by \$10 per acre-foot and directed that any undercollection during 2006 be recorded and amortized through the rates over the next three years. It is recommended that the treatment surcharge be increased \$10 per acre-foot from the current level of \$157 per acre-foot to \$167 per acre-foot. This increase is not sufficient to recover the undercollection. As is the case with other rate elements, the treatment surcharge increase is less than the forecasted cost-of-service in order to mitigate impacts on member agencies. Rates will be increased to full cost-of-service levels in 2010. This increase is due to increases in capital financing costs for treatment plant refurbishments/replacement, the Ozone Retrofit Program and treatment plant expansion, and the deferred \$10 per acre-foot from the fiscal year 2005/06 action plus interest.
- h. **Capacity Charge.** The Capacity Charge is recommended to remain unchanged at \$6,800 per cubic-foot-second. The Capacity Charge is a fixed charge levied on the maximum summer day demand placed on the system between May 1 and September 30 for the three calendar-year period ending December 31, 2007. The Capacity Charge recovers the cost of providing peak capacity within the distribution system. Daily flow measured between May 1 and September 30 for purposes of billing the Capacity Charge will include all deliveries made by Metropolitan to a member agency or member agency customer including water transfers, exchanges and agricultural deliveries, but excluding replenishment service. The resolution of intent to impose a capacity charge is shown in [Attachment 4](#). It should also be noted that

the capacity charge is not a capacity charge as defined by AB 2951, a legislation signed by the Governor last year.

- i. **Readiness-to-Serve Charge.** It is recommended that the Readiness-to-Serve Charge increase to \$92 million. This increase is due to increases in capital financing costs for conveyance and storage. Metropolitan's Readiness-to-Serve Charge recovers costs associated with standby and peak conveyance capacity and system emergency storage capacity. The Readiness-to-Serve Charge is allocated among the member agencies on the basis of each agency's ten-year rolling average of firm demands (including water transfers and exchanges conveyed through system capacity). Revenues equal to the amount of Standby Charges will continue to be credited against the member agency's Readiness-to-Serve Charge obligation unless a change is requested by the member agency. Each agency's estimated Readiness-to-Serve Charge is shown in [Attachment 3](#).
- j. **Replenishment Water Rate.** It is recommended that the untreated replenishment water rate increase from \$258 per acre-foot to \$294 per acre-foot reflecting the increase in full service rates. It is also recommended that the treated replenishment water rate increase from \$390 per acre-foot to \$436 per acre-foot, reflecting the increase in treatment costs. The Replenishment program will be reviewed and updated through the 2009 Integrated Resources Plan Update. Replenishment service has been curtailed since May 2007 and is expected to continue to be curtailed through fiscal year 2008/09. If, however, water supply conditions improve, and Metropolitan is able to make replenishment water available to its member agencies, it is recommended that the rate for these deliveries not be increased by the Water Supply Surcharge. As described in [Attachment 2](#) – Fiscal Year 2008/09 Cost of Service Study, there are a number of reasons that the replenishment rate may be changed. Some member agencies have proposed that the replenishment rate be set at the same proportion to Tier 1 rates that existed in 2003 (see testimony provided by Municipal Water District of Orange County in [Attachment 1](#)). Rather than making such a determination at this point, pending the outcome of the Integrated Resources Plan Update, it is recommended that the replenishment rate not be increased to recover the Water Supply Surcharge. Since transfer water is not purchased to meet these discretionary deliveries, and to encourage member agencies to make efforts to take delivery of replenishment water in the unlikely event it is available for even short periods in 2009, mitigating the rate increase for replenishment water in this way is recommended.
- k. **Agricultural Water Rate.** It is recommended that the untreated agricultural water rate increase from \$261 per acre-foot to \$322 per acre-foot to reflect the increase in costs. It is also recommended that the treated agricultural water rate increase from \$394 per acre-foot to \$465 per acre-foot, consistent with the increase in costs.

### **Alternative Rates and Charges**

Two alternatives to the recommended rates and charges were described in the January board letter (see Table 1). Under Option 2, overall rates and charges would increase by 9.8 percent, and it is anticipated that \$191 million of reserves would be utilized during fiscal year 2008/09 to meet expenditures. Reserve levels are expected to end the year significantly below the Board's minimum objectives, and the risk of higher rate increases in future years would be increased. In 2010, rates would be expected to increase by a similar amount, at least 9 to 10 percent, followed by a 5 percent increase in 2011. Option 3 would increase rates and charges to recover the full cost of service over a 12-month period or about 20.2 percent. Reserves would still be used in 2008/09, as rates would not go into effect until January 1, 2009, and would result in increased revenues for only four months of the fiscal year. But, this rate scenario would have the added benefit of lower risk that rates would have to be raised in 2010. Current estimates would include rate increases in 2010 and 2011 of 2 to 3 percent, reflecting inflationary impacts.

### **Future Risks**

As has been highlighted over the past year, there are many risks to Metropolitan's financial forecast. These risks include:

Hydrologic risk and water sales – Water sales could be lower than forecast due to both water supply conditions and heavier than expected rain. Water supply conditions could necessitate aggressive conservation, which could result in lower water sales. Higher rainfall in Southern California could also depress sales. Lower sales would result in higher rate increases in the future.

Delta Conveyance – Funding for capital expenditures to improve Delta conveyance has not been included in current rate forecasts. Additional funding for this purpose could increase future rates. The forecast also assumes current estimates associated with California ESA-related pumping restrictions. If pumping restrictions are increased in the future, this could result in additional need transfers and other supply development, which would increase future water rates.

Funding Other Post Employment Benefits (OPEB) – Current forecasts do not include funding of OPEB, beyond current benefit payments. A decision to begin funding OPEB at a level beyond current benefit payments would result in higher water rates.

Hyatt-Thermalito – Forecasts assume the Department of Water Resources continues to handle the allocation of power generation benefits from the Hyatt-Thermalito generation complex in the current manner. A negative result in the Hyatt-Thermalito lawsuit for Metropolitan could result in higher power costs on the SWP, leading to increased water rates in the future.

Cost of power – In addition to the potential effects of the Hyatt-Thermalito case, increases in power rates could lead to higher imported water supply costs. Greenhouse gas legislation could result in changes to the way Metropolitan and DWR develop power supply portfolios. While the impacts of this legislation are currently unknown, it may result in a shift from lower cost power supplies with higher greenhouse gas emissions to higher cost supplies that carry a smaller carbon footprint.

Water quality and chemical costs – Increases in future water quality regulations, chemical costs, and source water quality could each result in higher future water rates.

SWP infrastructure replacement – Funding of rehabilitation and replacement of SWP facilities could greatly affect future State Water Contract costs. These costs could include Metropolitan's share of funding future capital improvements at Lake Perris and San Luis Reservoir.

Metropolitan's aging infrastructure – Greater than expected rehabilitation and replacement costs of Metropolitan's aging infrastructure would result in increase future capital financing expenditures.

### **Policy**

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Metropolitan Water District Administrative Code Sections 4301 (a) (b): Cost of Service and Revenue Requirement

Metropolitan Water District Administrative Code Sections 4304 (c) (f): Apportionment of Revenues and Setting of Water Rates and Charges to Raise Firm Revenues

### **California Environmental Quality Act (CEQA)**

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CEQA determination for Options #1, #2, #3, and #4:

The proposed actions are not defined as a project under CEQA, because they involve continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed actions are not subject to CEQA because they involve 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).

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

## Board Options

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### Option #1

Adopt the CEQA determination and

- a. Approve water rates effective January 1, 2009 as shown in Table 1;
- b. Adopt Resolution to Impose the Readiness-to-Serve Charge in the form shown as [Attachment 3](#) to this letter; and
- c. Adopt Resolution to Impose the Capacity Charge in the form shown as [Attachment 4](#) to this letter.

**Fiscal Impact:** Revenues from rates and charges of \$1.142 billion in fiscal year 2008/09, and an increase in the effective rate of 9.8 percent plus a \$25 per acre-foot surcharge if the rates and charges are adopted as recommended. An increase of \$167 million in revenues over the calendar year 2009 in which new rates are effective.

### Option #2

Adopt the CEQA determination and

- a. Approve water rates effective January 1, 2009 as shown in Table 1;
- b. Adopt Resolution to Impose the Readiness-to-Serve Charge in the form shown as [Attachment 3](#) to this letter; and
- c. Adopt Resolution to Impose the Capacity Charge in the form shown as [Attachment 4](#) to this letter.

**Fiscal Impact:** Revenues from rates and charges of \$1.128 billion in 2008/09, and an increase in the effective rate of 9.8 percent if the rates and charges are adopted as recommended. An increase of \$117 million in revenues over the calendar year 2009 in which new rates are effective.

### Option #3

Adopt the CEQA determination and

- a. Approve water rates effective January 1, 2009 as shown in Table 1;
- b. Adopt Resolution to Impose the Readiness-to-Serve Charge in the form shown as [Attachment 3](#) to this letter; and
- c. Adopt Resolution to Impose the Capacity Charge in the form shown as [Attachment 4](#) to this letter.

**Fiscal Impact:** Revenues from rates and charges of \$1.165 billion in 2008/09, and an increase in the effective rate of 20.2 percent if the rates and charges are adopted as recommended. An increase of \$236 million in revenues over the calendar year 2009 in which new rates are effective.

### Option #4

Adopt the CEQA determination and instruct staff to modify the recommended rates and charges.

**Fiscal Impact:** Unknown

**Staff Recommendation**

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Option #1

  
\_\_\_\_\_  
Brian G. Thomas  
Chief Financial Officer

2/29/2008  
Date

  
\_\_\_\_\_  
Jeffrey Kightlinger  
General Manager

2/29/2008  
Date

**Attachment 1 – Public Comments**

**Attachment 2 – Metropolitan Water District of Southern California, FY 2008/09 Cost of Service**

**Attachment 3 – Resolution to Fix and Adopt Readiness-to-Serve Charge**

**Attachment 4 – Resolution to Fix and Adopt Capacity Charge**

BLA #5761

Attachment 1

**Public Comments**

Public Hearing Held February 11, 2008

Comments of Mr. Matt Stone  
Associate General Manager  
Municipal Water District of Orange County

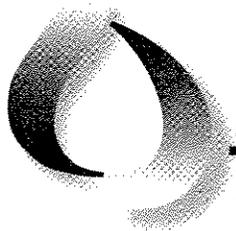
(MWD staff notes)

The Municipal Water District of Orange County expressed its appreciation for Metropolitan's staff work to diligently prepare forecasts which identify potential risks, despite the emergence of unforeseen risk factors such as the Delta smelt. Replenishment service has been cut since May 2007 and is expected to be curtailed through next year. Local agencies have been pumping water out of storage, which is in accord with the ideal operation of the program, that is, to maximize storage in wet years and take it out of storage in dry years. Given the current expectations of less surplus water being available in the near future, it is imperative to ensure that not a drop of storage water is not stored when available. In addition, there exists an opportunity to review the current rate making methodology for Replenishment service as noted in the Cost-of-Service report in the January 2008 Board Letter. Since 2003, Replenishment rates have been increasing dollar-for-dollar to the Full Service rates. As a result, the percent increase in Replenishment rates has exceeded the percent increase in Full Service rates. Therefore, MWDOC recommends returning to the 2003 proportional rate increase methodology.

Comments of Mr. Chris Millington  
Global Water Works

(MWD staff notes)

Global Water Works specializes in technologies for Agricultural and Residential customers by using underground irrigation systems, which save up to 80% of usage. Their technology has been in existence for the last 4 years, it works, and can help.



**Inland Empire Utilities Agency**

**A MUNICIPAL WATER DISTRICT**

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February 11, 2008

Mr. James H. Bond  
Chairman  
Business and Finance Committee  
Metropolitan Water District of Southern California  
Post Office Box 54153  
Los Angeles, California 90012-0153

Subject: Water Rate Public Hearing

Dear Chairman Bond:

On behalf of the Board of Directors of the Inland Empire Utilities Agency, I am pleased to offer these recommendations for the proposed rates for 2009. IEUA is in support of the MWD staff Option 2 (about a 9.8 percent increase plus the \$25 per AF surcharge for water transfer water purchases) as modified in the attached paper.

My compliments to the Metropolitan Water District staff, in particular, Brian Thomas in working with the member agencies and other agencies within the MWD service area on the 2009 rate recommendations. Clearly, significant rate increases will be needed over the next 3 to 5 years. IEUA supports the development of a consensus on the revenue requirements needed to ensure MWD has adequate financial resources to solve our "significant" water problems facing the region.

If you have any question about these recommendations, please do not hesitate to contact me.

Sincerely,

INLAND EMPIRE UTILITIES AGENCY

Richard W. Atwater  
Chief Executive Officer  
General Manager

Attachment

cc: Jeff Kightlinger, General Manager, Metropolitan Water District  
Brian Thomas, Chief Financial Officer, Metropolitan Water District  
Inland Empire Utilities Agency Board of Directors

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General Manager

## IEUA Recommended 2009 Water Rates and Charges

### Metropolitan Water District

February 11, 2008

**Summary.** Metropolitan Water District Staff Option 2 with proposed changes to its rates and charges as shown in the following table:

Rate Element	Effective on January 1, 2008	Effective on January 1, 2009	Change	% Change
Tier 1 Supply (\$/af)	73	109	36	49.3%
Tier 2 Supply (\$/af)	171	250	79	46.1%
Water Supply Surcharge (\$/af)	--	25	25	NA
System Access (\$/af)	143	143	--	0.0%
Water Stewardship (\$/af)	25	25	--	0.0%
System Power (\$/af)	110	110	--	0.0%
Treatment (\$/af)	157	167	10	6.3%
Capacity Charge (\$/cfs)	6,800	6,800	--	0.0%
Readiness-to-Serve (\$M)	82	82	10	12.2%
Treated Replenishment (\$/af)	390	436	46	11.8%
Untreated Replenishment (\$/af)	258	295	36	13.9%
Treated IAWP (\$/af)	394	465 (1)	71	18.0%
Untreated IAWP (\$/af)	261	322 (1)	61	23.3%
Untreated Tier 1	351	412	61	17.3%
Untreated Tier 2	449	528	79	17.5%
Treated Tier 1	508	579	71	13.9%
Treated Tier 2	606	695	89	14.6%

(1) IAWP rates include the \$25/af Water Supply Surcharge.

As shown above, Tier 1 Full Service Rates will be increasing by \$61/af, while Treated Tier 1 Full Service Rates will be increasing by \$71/af. In addition, the current proposal will result in similar increases in the replenishment and agricultural rates.

**Revenue Impact.** This proposed increase is expected to generate about \$157 million in additional revenues over calendar year 2009. This is based on water sales of 2.23 million acre-feet during the period.

**Water Supply Surcharge.** This proposal includes an increase in the base water supply costs (Tier 1) of \$36/af to help fund the increasing cost of base supply programs, including increasing cost of State Project supplies,

San Bernardino Valley Municipal Water District Transfers, the Palo Verde Irrigation District program, and increased withdrawals from storage programs, such as Arvin-Edison and Semitropic. In addition, the proposal includes a \$25/af Water Supply Surcharge to fund additional transfers necessitated by the recent Federal Court decision on Delta Smelt that will reduce the State Project's flexibility and supply reliability. This \$25/af Water Supply Surcharge will generate around \$50 million, which will be used to purchase transfers along the Colorado River, in the Central Valley and in the Sacramento Valley and Feather River watersheds. It is anticipated that these purchases will be necessary to supplement deliveries from Metropolitan's base supplies to help offset the need to allocate water supplies in the coming year.

**Other Cost Drivers.** The three primary reasons for the need for this substantial increase include the cost of State Water Project deliveries, the cost of additional water supplies, and increasing debt service to pay for debt that has been issued to fund Metropolitan's ongoing capital program. While Metropolitan has taken many steps to help reduce and mitigate these costs, including savings of over \$100 million in debt service through restructuring and refunding debt, rescheduling about \$500 million of capital work, and saving over \$5 million through business process improvements in 2007 and 2008, these three cost drivers, along with other costs, such as the quagga mussel control program and settlement of the Cargill litigation have outpaced Metropolitan's ability to hold rates at their current levels.

**Future Risks.** Metropolitan has identified a number of other factors that could continue to put upward pressure on water rates and charges in the future. These include:

1. The increasing cost of power as the state implements renewable and green power,
2. Funding Metropolitan's unfunded retired health liability,
3. Costs associated with repair and replacement of the State Water Project system (e.g., Perris Dam and San Luis Reservoir),
4. Costs associated with long-term delta infrastructure, including conveyance around the delta, and
5. The possibility of lower water sales due to both drought and heavier than normal rainfall.

As a result, it is prudent to raise rates now to avoid even higher increases in the future as some or all of these risks materialize.

**Use of Reserves.** Under the proposed rates, Metropolitan would use about \$170 million of Water Rate Stabilization Fund and Water Stewardship Funds, pulling balances to under \$70 million at the end of fiscal year 2008/09. This is about \$30 million under the Board's minimum target.

**Capital Funded from Revenues.** The proposal includes funding \$85 million of capital expenditures from revenues or reserves in 2007/08, and \$95 million in 2008/09.

## PROPOSED MODIFICATIONS TO CURRENT RECOMMENDATION

**Support for Overall Increase.** It is in the region's best interest to ensure Metropolitan's financial stability in these uncertain times. The importance of Metropolitan's strong credit ratings is shown during the current dislocation in the financial markets – Metropolitan retains options to manage through the dramatic changes in the variable rate debt market, and continue to receive favorable interest rates. While the current proposal is a significant increase, it is better to plan now rather than be hit with mid-year or even higher increases in the future.

**Water Supply Surcharge.** Given that it is the cost of alternative water supplies that is driving almost \$200 million of the increase in costs, a water supply surcharge defining the reason for a large part of the increase is appropriate, and a sound way to communicate the need for increased water rates.

**Replenishment Rates.** The current rates and revenues are based on a sales forecast that assumes replenishment deliveries are not available over 2008 and 2009. Given that assumption, it is not appropriate to assess the Water Supply Surcharge to replenishment deliveries in the event that such supplies are available. Water is not being purchased to meet these types of discretionary deliveries. The benefit of this change would be to encourage replenishment agencies to purchase water during those windows if, and when, it is available. As a result, rather than following Metropolitan's practice since 2003 of increasing replenishment rates dollar for dollar with Tier 1 Full Service Rates, replenishment rates would not be assessed the \$25/af Water Supply Surcharge.

**Capital Funding from Revenues.** Given the risks facing Metropolitan in the next few years, and the need to help mitigate increases in rates and charges, it is appropriate for Metropolitan to retain liquidity and preserve some of its Water Rate Stabilization Funds to be prepared for future unknowns. As such, reducing expenditures on capital that come from revenues and reserves in 2007/08 and 2008/09 would be one way to help preserve liquidity. It is recommended that Metropolitan limit these "PAYGO" expenditures to short-lived projects (e.g., information technology) and other capital projects (e.g., reimbursable capital) that are not appropriately funded with long-term bonds. This would preserve about \$105 million of reserves by the end of fiscal 2008/09. It is further recommended that Metropolitan staff continue to monitor costs and revenues, and if there is sufficient revenue to avoid drawing reserves below minimum targets, that "PAYGO" amounts be increased.

**Discounted Water Programs.** It is recommended that the Board evaluate the replenishment program pricing and use as part of the IRP Update as Metropolitan evaluates its other storage options. It is further recommended that staff be directed to bring options for the Interim Agricultural Water Program pricing to the board in the May/June time period for further discussion and action. Such options should include options ranging from continuing the program as it exists today to eliminating or phasing out the existing program.

**Board of Directors**

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Jacob J. Krauss, *Secretary*  
Ed K. Sprague, *Director*



**General Manager**  
Kimberly A. Thorne  
**General Counsel**  
Wesley Peltzer

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February 8, 2008

Timothy F. Brick  
Chairman of the Board  
Metropolitan Water District of Southern California  
700 N. Alameda Street  
Los Angeles, CA 90012

Re: Public Hearing on Proposed Water Rates  
***Objection to Proposed Rates and Charges***

Dear Chairman Brick and Board of Directors:

The Olivenhain Municipal Water District (District) would like to officially be entered into the public record of the Metropolitan Water District (MWD) Business and Finance Committee Public Hearing as objecting to the proposed water rate charges for fiscal year 2008/2009, as recommended in the General Manager's letter signed on December 27, 2007. The District, is a member agency of the San Diego County Water Authority, and provides retail water treatment and supply to approximately 60,000 customers in North County San Diego.

On behalf of our customers, the District must express its deep concern and objection regarding the substantial, unforecasted water rate increases now being proposed by MWD. The District, in its own prudent financial planning, looks to MWD rate forecasts in projecting its own future rates and charges. For the past several years, an 8% rate increase for fiscal year 2008/2009 has been provided and publicized by MWD. Only in December 2007 did the three options for 9.8%, 9.8% plus a \$25 per acre foot surcharge, and a 20.2% option become public for planning purposes for retail water agencies. A smooth ramping of rates, rather than large rate spikes like this, is more easily absorbed by the end user – our ratepayers - and is, among other things, a suggestion we are putting forward today for your consideration.

The District appreciates that these are unprecedented times related to water supply, with judicial drought, historic dry year conditions, and agricultural water cutbacks being some of the more recent challenges. However, it is the end user – the retail customer – that must absorb all of these impacts. The farmers in our



*Metropolitan Water District  
February 8, 2008  
Page 2 of 2*

service area have already cut their water use by 30%. Our customers are stepping up and participating in the "20 Gallon Challenge." Our District is increasing its recycled water efforts, and, working to convert all of its golf courses to recycled water, with the golf courses paying for their own retrofits. All of these actions are wise water planning activities and the end users have stepped up to alleviate the pressure of these unprecedented water times. After our ratepayers have done everything we have asked them to do, it is just plain unfair to reward them with a 20.2% increase in water rates.

Instead, we request that your board evaluate what further steps might be taken to reduce overall expenditures in order to mitigate the proposed rate increases. For example, have you considered cutting the O&M budget by, say, 10% across the board? Have you fully evaluated your Capital Improvement Program to see what expenditures might be delayed (e.g., \$1.75 million for DVL recreation, \$25 million for La Verne shop facilities upgrade, \$10.2 million to replace telephone system – and more)? In these difficult times, it is especially important to show the public that we are doing everything we can to reduce expenditures and demonstrate that the budget is as lean as possible.

The District also has a concern about the proposed \$25 dollar surcharge. While we fully appreciate the need to secure water supply transfers, full credit should be given to agencies who have invested their own dollars to secure water supply transfers or increase conservation in order to mitigate MWD rate increases. Again, we would ask that your board take these additional factors into account before assessing the \$25 dollar surcharge on water purchased from MWD.

We appreciate the opportunity to be heard today and look forward to working with you to avoid rate spikes like this in the future. We believe that it is critical that MWD take into account the perspectives and needs of the retail water suppliers who are on the front line and directly accountable to the public we serve. Unforecasted rate impacts like this reduce our credibility and make it harder to get the job done for the public we serve.

Respectfully submitted,



Susan J. Varty  
Board President  
Olivenhain Municipal Water District

cc: San Diego County Water Authority

Metropolitan Water District of Southern California  
**Fiscal Year 2008/09 Cost of Service**

**February 1, 2008**

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## **1 Cost of Service**

Prior to discussing the specific rates and charges that make up the rate structure, it is important to understand the cost of service process that supports the rates and charges. The purpose of the cost of service process is to: (1) identify which costs should be recovered through rates and charges; (2) organize Metropolitan's costs into service functions; and (3) classify service function costs on the basis for which the cost was incurred. The purpose of sorting Metropolitan's costs in a manner that reflects the type of service provided (e.g. supply vs. conveyance), the characteristics of the cost (e.g. fixed or variable) and the reason why the cost was incurred (e.g. to meet peak or average demand) is to create logical cost of service "building blocks". The building blocks can then be arranged to design rates and charges with a reasonable nexus between costs and benefits.

### ***1.1 Cost of Service Process***

The general cost of service process involves the four basic steps outlined below.

#### ***Step 1 - Development Of Revenue Requirements***

In the revenue requirement step, the costs that Metropolitan must recover through rates and charges, after consideration of revenue offsets, are identified. The cash needs approach, an accepted industry practice for government-owned utilities, has historically been used in identifying Metropolitan's revenue requirements and was applied for the purposes of this study. Under the cash needs approach, revenue requirements include operating costs and annual requirements for meeting financed capital items (debt service, funding of replacement and refurbishment from operating revenues, etc.).

#### ***Step 2 – Identification of Service Function Costs***

In the functional allocation step, revenue requirements are allocated to different categories based on the operational functions served by each cost. The functional categories are identified in such a way as to allow the development of logical allocation bases. The functional categories used in the cost of service process include:

- Supply
- Conveyance and Aqueduct
- Storage
- Treatment
- Distribution
- Demand Management
- Administrative and General
- Hydroelectric

In order to permit functional allocation at the level of accuracy required, many of these functional categories are subdivided into more detailed sub-functions in the cost of service process. For example, costs for the Supply and Conveyance and Aqueduct functions are further subdivided into the sub-functions State Water Project (SWP), Colorado River Aqueduct (CRA), and Other. Similarly, costs in the Storage function are broken down into the sub-functions Emergency Storage, Drought Carryover Storage, and Regulatory Storage.

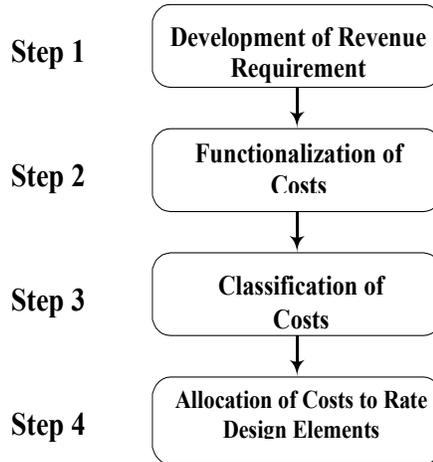
### Step 3 - Classification Of Costs

In the cost classification step, functionalized costs are separated into categories according to their causes and behavioral characteristics. Proper cost classification is critical in developing a rate structure that recovers costs in a manner consistent with the causes and behaviors of those costs. Under American Water Works Association (AWWA) guidelines, cost classification may be done using either the Base/Extra-Capacity approach or the Commodity/Demand approach. In the simplest sense, these approaches offer alternative means of distinguishing between utility costs incurred to meet average or base demands and costs incurred to meet peak demands. The Commodity/Demand approach was modified for its application to Metropolitan's rate structure by adding a separate cost classification for costs related to providing standby service. Analysis of system operating data indicated that a modified Commodity/Demand approach was the most appropriate for developing Metropolitan's cost of service classification bases.

### Step 4 - Allocation Of Costs To Rate Design Elements

The allocation of costs to the rate design elements depends on the purpose for which the cost was incurred and the manner in which the member agencies use the Metropolitan system. For example, costs incurred to meet average system demands are typically recovered by dollar per acre-foot rates and are allocated based on the volume of water purchased by each agency. Rates that are levied on the amount or volume of water delivered are commonly referred to as volumetric rates as the customer's costs vary with the volume of water purchased. Costs incurred to meet peak demands (referred to in this report as demand costs) are recovered through a peaking charge (the Capacity Charge) and are allocated to agencies based on their peak demand behavior. Costs incurred to provide standby service in the event of an emergency are referred to here as standby costs. Differentiating between costs for average usage and peak usage is just one example of how the cost of service process allows for the design of rates and charges that improves overall customer equity and efficiency. Figure 1 summarizes the cost of service process.

**Figure 1. The Cost of Service Process**



**1.2 Revenue Requirements**

The estimated revenue requirements presented in this report are for FY 2008/09. Throughout the report, FY 2008/09 is used as the “test year” to demonstrate the application of the cost of service process. Schedule 1 summarizes the FY 2008/09 revenue requirement by the major budget line items used in Metropolitan’s budgeting process. Current estimates indicate Metropolitan’s annual cash expenditures (including capital financing costs, but not construction outlays financed with bond proceeds) will total approximately \$1.496 billion in FY 2008/09.

The rates and charges do not have to cover this entire amount. Metropolitan generates a significant amount of revenue from interest income, hydroelectric power sales and miscellaneous income. These internally generated revenues are referred to as revenue offsets and are expected to generate about \$78.7 million in FY 2008/09. It is expected that Metropolitan will also generate about \$94.4 million in ad valorem property tax revenues and annexation charges. Property tax revenues are used to pay for a portion of Metropolitan’s general obligation bond debt service, and a portion of Metropolitan’s obligation to pay for debt service on bonds issued to fund the State Water Project. The total revenue offsets for FY 2008/09 are estimated to be around \$176 million. Therefore, the revenue required from rates and charges is the difference between the total costs and the revenue offsets, or \$1.32 billion. Approximately \$182 million from the Water Rate Stabilization and Water Stewardship Funds will be used to fund a portion of Metropolitan’s expenditures during 2008/09. Given an effective date of January 1, 2009, the rates and charges recommended in this report, combined with rates and charges effective through December 31, 2008, will generate a total of \$1.142 billion in 2008/09.

All of Metropolitan's costs fall under the broad categories of Departmental Costs or General District Requirements. Departmental Costs include budgeted items identified with specific organizational groups. General District Requirements consist of requirements associated with the Colorado River Aqueduct, State Water Project, the capital financing costs associated with the Capital Investment Program (CIP), and Water Management Programs. General District Requirements also include reserve fund transfers required by bond covenants and Metropolitan's Administrative Code.

When considered in total, General District Requirements make up approximately 70 percent of the absolute value of the allocated costs. The largest component of the revenue requirement relates to SWP expenditures, which make up approximately 29.2 percent of Metropolitan's FY 2008/09 revenue requirements. Metropolitan's SWP contract requires Metropolitan to pay its allocated share of the capital, minimum operations, maintenance, power and replacement costs incurred to develop and convey its water supply entitlement, irrespective of the quantity of water Metropolitan takes delivery of in any given year. Metropolitan's capital financing program is the second largest component of the revenue requirement, constituting approximately 24.4 percent of the revenue requirement. Departmental O&M costs make up 19.5 percent of the total revenue requirement in FY 2008/09. Water System Operations is the largest single component of the Departmental Costs and accounts for 11.4 percent of the revenue requirements. Water System Operations responsibilities include operating and maintaining Metropolitan's pumping, storage, treatment, and hydroelectric facilities, as well as the Colorado River Aqueduct and other conveyance and supply facilities.

**Schedule 1. Revenue Requirements (by budget line item)**

	<b>Fiscal Year Ending 2009</b>	<b>% of Revenue Requirements (1)</b>
<b>Departmental Operations &amp; Maintenance</b>		
Office of the General Manager & Human Resources	\$ 15,034,000	0.9%
External Affairs	20,537,000	1.2%
Water System Operations	190,165,000	11.4%
Chief Financial Officer	5,956,100	0.4%
Corporate Resources	57,281,800	3.4%
Real Property Development & Mgmt	7,304,500	0.4%
Water Resource Management	19,086,000	1.1%
Ethics Department	457,600	0.0%
General Counsel	7,723,200	0.5%
Audit Department	2,037,200	0.1%
<b>Total</b>	<b>325,582,400</b>	<b>19.5%</b>
<b>General District Requirements</b>		
State Water Project	488,599,328	29.2%
Colorado River Aqueduct	45,908,754	2.7%
Supply Program Costs paid from operating revenues	139,386,012	8.3%
Water Management Programs	53,674,616	3.2%
Capital Financing Program	407,702,480	24.4%
Other O&M	17,445,300	1.0%
Increase (Decrease) in Required Reserves	17,400,000	1.0%
<b>Total</b>	<b>1,170,116,489</b>	<b>70.0%</b>
<b>Revenue Offsets</b>	<b>(175,831,271)</b>	<b>10.5%</b>
<b>Net Revenue Requirements</b>	<b>\$ 1,319,867,618</b>	<b>100.0%</b>

(1) Given as a percentage of the absolute values of total dollars allocated.  
Totals may not foot due to rounding

### ***1.3 Service Function Costs***

Several major service functions result in the delivery of water to Metropolitan's member agencies. These include the supply itself, the conveyance capacity and energy used to move the supply, storage of water, distribution of supplies within Metropolitan's system, and treatment of these supplies. Metropolitan's rate structure recovers the majority of the cost of providing these functions through rates and charges.

The functional categories developed for Metropolitan's cost of service process are consistent with the American Water Works Association rate setting guidelines, a standard chart of accounts for utilities developed by the National Association of Regulatory Commissioners (NARUC), and the National Council of Governmental Accounting. Because all water utilities are not identical, the rate structure reflects Metropolitan's unique physical, financial, and institutional characteristics.

A key goal of functional allocation is to maximize the degree to which rates and charges reflect the costs of providing different types of service. For functional allocation to be of maximum benefit, two criteria must be kept in mind when establishing functional categories.

- The categories should correlate charges for different types of service with the costs of providing those different types of service; and
- Each function should include reasonable allocation bases by which costs may be allocated.

Each of the functions developed for the cost of service process is described below.

- *Supply.* This function includes costs for those SWP and CRA facilities and programs that relate to maintaining and developing supplies to meet the member agencies' demands. For example, Metropolitan's supply related costs include investments in Phase I of the Conservation Agreement with the Imperial Irrigation District and the agreement with Palo Verde Irrigation District. The SWP Delta Water Charge is included as a cost of supply along with the cost of storage and transfer programs such as Semitropic Water Storage Program, and the Arvin-Edison Water Storage Program. Costs for groundwater conjunctive use programs within Metropolitan's service area, such as the North Las Posas Groundwater Basin Conjunctive Use Agreement are also included.
- *Conveyance and Aqueduct.* This function includes the capital, operations, maintenance, and overhead costs for SWP and CRA facilities that convey water through Metropolitan's internal distribution system. Variable power costs for the SWP and CRA are also considered to be Conveyance and Aqueduct costs but are separately reported under a "power" sub-function. Conveyance and Aqueduct facilities can be distinguished from Metropolitan's other facilities primarily by the fact that they do not typically include direct connections to the member agencies. For purposes of this study, the Inland Feeder Project functions as an extension of the SWP East Branch and is therefore considered a Conveyance and Aqueduct facility as well.
- *Storage.* Storage costs include the capital financing, operating, maintenance, and overhead costs for Diamond Valley Lake, Lake Mathews, Lake Skinner, and five smaller regulatory reservoirs within the distribution system. Metropolitan's larger storage facilities are operated to provide (1) emergency storage in the event of an earthquake or similar system outage; (2) drought storage that produces additional supplies during times of shortage; and

- (3) regulatory storage to balance system demands and supplies and provide for operating flexibility. To reasonably allocate the costs of storage capacity among member agencies, the storage service function is categorized into sub-functions of emergency, drought, and regulatory storage.
- *Treatment.* This function includes capital financing, operating, maintenance, and overhaul costs for Metropolitan's five treatment plants and is considered separately from other costs so that treated water service may be priced separately.
  - *Distribution.* This function includes capital financing, operating, maintenance, and overhead costs for the "in-basin" feeders, canals, pipelines, laterals, and other appurtenant works. The "in-basin" facilities are distinguished from Conveyance and Aqueduct facilities at the point of connection to the SWP, Lake Mathews, and other major turnouts along the CRA facilities.
  - *Demand Management.* A separate demand management service function has been used to clearly identify the cost of Metropolitan's investments in local resources like conservation, recycling, and desalination.
  - *Administrative and General (A&G).* These costs occur in each of the Groups' departmental budgets and reflect overhead costs that cannot be directly functionalized. The cost-of-service process allocates A&G costs to the service functions based on the labor costs of non-A&G dollars allocated to each function.
  - *Hydroelectric.* Hydroelectric costs include the capital financing, operating, maintenance, and overhead costs incurred to operate the 16 small hydroelectric plants located throughout the water distribution system.

### ***1.3.1 Functional Allocation Bases***

The functional allocation bases are used to allocate a cost to the various service functions. The primary functional allocation bases used in the cost-of-service process are listed below.

- Direct assignment
- Work-In-Progress or Net Book Value plus Work-In-Progress
- Prorating in proportion to other allocations
- Manager analysis

Schedule 2 summarizes the amounts of total cost allocated using each of the above types of allocation bases.

**Schedule 2. Summary of Functional Allocations by Type of Allocation Basis**

<b>Primary Functional Allocation Bases</b>	<b>Estimated for FY 2009</b>	<b>% of Allocated Dollars</b>
Direct Assignment	\$ 956,999,308	57.3%
Work in Progress/Net Book Value	444,320,680	26.6%
Prorating	104,263,016	6.2%
Manager Analysis	26,449,000	1.6%
Other	\$ 139,386,012	8.3%
<b>Total Dollars Allocated</b>	<b>\$ 1,671,418,015</b>	<b>100.0%</b>
<b>Portion of Above Allocations Relating to:</b>		
Revenue Requirements before Offsets	1,495,798,889	
Revenue Offsets	175,619,126	
<b>Total Dollars Allocated</b>	<b>\$ 1,671,418,015</b>	

Totals may not foot due to rounding

Each of the primary allocation bases is discussed in detail in the remainder of this section. Discussion of each allocation basis includes examples of costs allocated using that particular basis.

**(a) Direct assignment**

Direct assignment makes use of a clear and direct connection between a revenue requirement and the function being served by that revenue requirement. Directly assigned costs typically include: costs associated with specific treatment plants, purely administrative costs, and certain distribution and conveyance departmental costs. Examples of costs that are directly assigned to specific functional categories are given below.

- \* Water System Operations Group departmental costs for treatment plants are directly assigned to treatment.
- \* Transmission charges for State Water Contract are directly assigned to conveyance SWP.

**(b) Work-In-Progress; Net Book Value Plus Work-In-Progress**

Capital financing costs, including debt service and funding replacements and refurbishments from operating revenues, comprise about 31 percent of Metropolitan's annual revenue requirements. One approach would be to allocate payments on each debt issue in direct proportion to specific project expenditures made using bond proceeds. But, this approach would result in a high degree of volatility in relative capital cost allocations from year to year. The approach used in this analysis is one widely used in water industry cost of service studies. Capital and debt-related costs (including repair and replacement costs paid from current revenues) are allocated on the basis of the relative net book values of fixed assets within each functional category. This approach produces capital cost allocations that are consistent with the functional distribution of assets. Also, since the allocation basis is tied to fixed asset records rather than debt payment records, the resulting allocations are more reflective of the true useful lives of assets. Use of net book values as an allocation basis provides an improved matching of functional costs with asset lives. A listing of fixed asset net book values summarized by asset function is shown in Schedule 3.

**Schedule 3. Net Book Value and Work in Progress Allocation Base**

<b>Functional Categories</b>	<b>NBV for FY 2009</b>	<b>% of Total NBV</b>
Source of Supply	\$ 63,724,419	1.0%
Conveyance & Aqueduct	1,167,861,420	17.6%
Storage	2,054,793,299	31.0%
Treatment	2,016,612,339	30.4%
Distribution	1,018,338,117	15.3%
Administrative & General	219,052,690	3.3%
Hydroelectric	97,578,016	1.5%
<b>Total Fixed Assets Net Book Value</b>	<b>\$ 6,637,960,301</b>	<b>100.0%</b>

Totals may not foot due to rounding

In most instances, the cost-of-service process uses net book value *plus* work-in-progress to develop allocation bases for debt and capital costs. For organizational units handling current construction activity, however, allocations are based on work-in-progress alone. For these organizational units, exclusion of net book value from the allocation basis is done because the costs being allocated relate directly to work in progress not yet reflected in the completed assets records.

Examples of revenue requirements allocated using these net book value and work-in-progress allocations are shown below.

- \* General Obligation and Revenue Bond Debt Service: *allocated using Work In Progress plus Net Book Value.*
- \* Annual deposit of operating revenue to replacement and refurbishment fund: *allocated using Work In Progress plus Net Book Value.*

To calculate the relative percentage of fixed assets in each functional category Metropolitan staff conducted a detailed analysis of historical accounting records and built a database of fixed asset accounts that contains records for all facilities currently in service and under construction. Each facility was sorted into the major service function that best represented the facilities primary purpose and was then further categorized into the appropriate sub-functions described earlier.

#### **(c) Prorating in proportion to other allocations**

Utility cost of service studies frequently contain line items for which it would be difficult to identify an allocation basis specific to that line item. In these cases, the most logical allocation basis is often a prorata blend of allocation results calculated for other revenue requirements in the same departmental group, or general category. Reasonable prorata allocations are based on a logical nexus between a cost and the purpose which it serves. For example: Human Resources Section costs are allocated using all labor costs, since Human Resources spends its time and resources attending to the labor force.

#### **(d) Manager analyses**

The functional interrelationships of some organizational units are so complex and/or dynamic that reliable allocation bases can only be developed with extensive input from the organization's managers. In these cases, managers use their first-hand knowledge of the organization's internal operations to generate a functional analysis of departmental costs. An example of revenue requirements allocated based on manager analyses is: Water System Operations Group: Operations Planning Unit.

A summary of the functional allocation results is shown in Schedules 4 and 5. Schedule 4 provides a breakdown of the revenue requirement for FY 2008/09 into the major service functions and sub-functions prior to the re-distribution of administrative and general costs. Schedule 5 serves as a cross-reference summarizing how the budget line items are distributed among the service functions. The largest functional component of Metropolitan's revenue requirement is the Conveyance and Aqueduct function, which constitutes approximately 38.6 percent of the allocated revenue requirement.

**Schedule 4. Revenue Requirement (by service function)**

<b>Functional Categories</b>	<b>Fiscal Year Ending 2009</b>	<b>% of Allocated Dollars (1)</b>
<b>Source of Supply</b>		
CRA	\$ 38,050,443	2.8%
SWP	168,578,099	12.5%
Other Supply	15,125,172	1.1%
<b>Total</b>	<b>221,753,714</b>	<b>16.4%</b>
<b>Conveyance &amp; Aqueduct</b>		
CRA		
<i>CRA Power (net of sales)</i>	40,224,926	3.0%
<i>CRA All Other</i>	38,692,293	2.9%
SWP		
<i>SWP Power</i>	218,823,792	16.2%
<i>SWP All Other</i>	170,630,375	12.6%
Other Conveyance & Aqueduct	53,714,059	4.0%
<b>Total</b>	<b>522,085,445</b>	<b>38.6%</b>
<b>Storage</b>		
Storage Costs Other Than Power		
<i>Emergency</i>	62,717,507	4.6%
<i>Drought</i>	52,254,152	3.9%
<i>Regulatory</i>	12,496,258	0.9%
Wadsworth plant pumping/generation	(1,024,992)	0.1%
<b>Total</b>	<b>126,442,924</b>	<b>9.5%</b>
<b>Treatment</b>		
Jensen	44,856,429	3.3%
Weymouth	37,654,128	2.8%
Diemer	41,754,262	3.1%
Mills	35,167,649	2.6%
Skinner	58,240,395	4.3%
<b>Total</b>	<b>217,672,861</b>	<b>16.1%</b>
<b>Distribution</b>	114,934,796	8.5%
<b>Demand Management</b>	65,162,208	4.8%
<b>Administrative &amp; General</b>	(15,268,896)	1.1%
<b>Hydroelectric</b>	67,084,567	5.0%
<b>Total Functional Allocations:</b>	<b>\$ 1,319,867,618</b>	<b>100.0%</b>

(1) Given as a percentage of the absolute values of total dollars allocated.  
Totals may not foot due to rounding

**Schedule 5. Service Function Revenue Requirements (by budget line item)**

	Source of Supply	Conveyance & Aqueduct	Storage	Water Quality	Treatment	Distribution	Demand Management	Hydro Electric	Administrative & General	Total \$ Allocated
<b>Departmental Operations &amp; Maintenance</b>										
Office of the General Manager & Human Resources	\$ 1,137,596	\$ 1,391,398	\$ 719,059	\$ -	\$ 3,363,091	\$ 2,377,920	\$ 338,789	\$ 168,927	\$ 5,537,220	\$ 15,034,000
External Affairs	-	-	-	-	-	-	6,360,210	-	14,176,790	20,537,000
Water System Operations	11,719,877	27,370,902	3,436,923	-	93,589,648	49,240,489	8,155	3,397,732	1,401,274	190,165,000
Chief Financial Officer	-	-	-	-	-	-	-	-	5,956,100	5,956,100
Corporate Resources	2,254,139	6,231,837	7,847,317	-	12,492,529	7,533,745	610,804	615,650	19,695,780	57,281,800
Real Property Development & Mgmt	-	-	7,304,500	-	-	-	-	-	-	7,304,500
Water Resource Management	12,033,807	13,846	-	-	192,126	1,454,920	5,184,241	-	207,060	19,086,000
Ethics Department	-	-	-	-	-	-	-	-	457,600	457,600
General Counsel	-	-	-	-	-	-	-	-	7,723,200	7,723,200
Audit Department	-	-	-	-	-	-	-	-	2,037,200	2,037,200
<b>Total Departmental O&amp;M</b>	<b>27,145,419</b>	<b>35,007,982</b>	<b>19,307,799</b>	<b>-</b>	<b>109,637,394</b>	<b>60,607,074</b>	<b>12,502,200</b>	<b>4,182,309</b>	<b>57,192,224</b>	<b>325,582,400</b>
<b>General District Requirements</b>										
State Water Project	54,260,634	434,338,694	-	-	-	-	-	-	-	488,599,328
Colorado River Aqueduct	-	45,908,754	-	-	-	-	-	-	-	45,908,754
Water Transfers and Storage Programs	139,386,012	-	-	-	-	-	-	-	-	139,386,012
Demand Management	-	-	-	-	-	-	53,674,616	-	-	53,674,616
Capital Financing Program	3,440,182	63,047,358	110,928,647	-	123,860,013	89,332,873	-	5,267,779	11,825,627	407,702,480
Other Operating Costs	1,346,038	3,145,112	720,512	-	3,448,249	2,369,579	353,276	167,835	5,894,699	17,445,300
Increase (Decrease) in Required Reserves	1,739,741	10,030,478	412,630	-	2,343,077	1,295,243	267,186	89,381	1,222,264	17,400,000
<b>Total General District Requirements</b>	<b>200,172,607</b>	<b>556,470,395</b>	<b>112,061,789</b>	<b>-</b>	<b>129,651,340</b>	<b>92,997,695</b>	<b>54,295,078</b>	<b>5,524,995</b>	<b>18,942,589</b>	<b>1,170,116,489</b>
<b>Revenue Offsets</b>	<b>(5,564,312)</b>	<b>(69,392,933)</b>	<b>(4,926,664)</b>	<b>-</b>	<b>(21,615,872)</b>	<b>(38,669,973)</b>	<b>(1,635,070)</b>	<b>(24,976,200)</b>	<b>(9,050,246)</b>	<b>(175,831,271)</b>
<b>Net Revenue Requirements</b>	<b>\$ 221,753,714</b>	<b>\$ 522,085,445</b>	<b>\$ 126,442,924</b>	<b>\$ -</b>	<b>\$ 217,672,861</b>	<b>\$ 114,934,796</b>	<b>\$ 65,162,208</b>	<b>\$ (15,268,896)</b>	<b>\$ 67,084,567</b>	<b>\$ 1,319,867,618</b>

Totals may not foot due to rounding

#### ***1.4 Classified Costs***

In the cost classification step, functionalized costs are further categorized based on the causes and behavioral characteristics of these costs. An important part of the classification process is identifying which costs are incurred to meet average demands vs. peak demands and which costs are incurred to provide standby service. As with the functional allocation process, the proposed classification process is consistent with AWWA guidelines, but has been tailored to meet Metropolitan's specific operational structure and service environment.

In the cost of service process, cost classification is done using a hybrid of two methods discussed in the AWWA M1 Manual, Principles of Water Rates, Fees and Charges. These two methods are the Commodity/Demand method and the Base/Extra Capacity method.

The Commodity/Demand method allocates costs that vary with the amount of water produced to the commodity category with all other costs associated with water production allocated to the demand category. In the Base/Extra Capacity method costs related to average demand conditions are allocated to the base category and capacity costs associated with meeting above average demand conditions are allocated to the extra capacity category.

The approach used to classify Metropolitan's costs differs from the Base/Extra Capacity method by the fact that costs are separated into a variable category and a fixed category. The Base/Extra Capacity method does not separate these costs into two categories but rather combines them into one category referred to as base costs. The approach used to classify Metropolitan's costs differs from the Commodity/Demand method in the fact that demand costs are separated into fixed commodity and fixed demand costs. The Commodity/Demand method would not make this distinction, but would combine these costs into the demand category. By using the hybrid method, costs are disaggregated to a lower level of detail, providing greater visibility to costs. Under the hybrid classification method, functional cost categories are reallocated into demand, commodity, or standby categories, which are discussed below. Classification of costs into these categories depends on an analysis of system capacity as well as actual system operating data.

Classification categories used in the analysis include:

- Fixed demand costs
- Fixed commodity costs
- Fixed standby costs
- Variable commodity costs
- Hydroelectric costs

Demand costs are incurred to meet peak demands. Only the direct capital financing costs were included in the demand classification category. A portion of capital financing costs was included in the demand cost category because in order to meet peak demands additional physical capacity is designed into the system and, therefore, additional capital costs are incurred. Commodity costs are generally associated with average system demands. Variable commodity costs include costs of chemicals, most power costs, and other cost components that increase or decrease in relation to the volume of water supplied. Fixed commodity costs include fixed operations and maintenance and capital financing costs that are not related to accommodating peak demands or standby service.

Standby service costs relate to Metropolitan's role in ensuring system reliability during emergencies such as an earthquake or an outage of a major facility like the Colorado River Aqueduct. The two principal components of the standby costs were identified as the emergency storage capacity within the system and the standby capacity within the State Water Project conveyance system.

An additional component used in Metropolitan's cost classification process is the hydroelectric component. While not a part of most water utilities' cost classification procedures, the hydroelectric classification component is necessary to segregate revenue requirements carried from the hydroelectric function established in the functional allocation process. Hydroelectric revenue requirements are later embedded in the distribution function. Any net revenues generated by the hydroelectric operations offset the distribution costs and reduce the System Access Rate. All users of the distribution system benefit proportionately from the revenue offset provided by the sale of hydroelectric energy.

Schedule 6 provides the classification percentages used to distribute the service function costs into demand, commodity and standby service classification categories. All of the supply costs are classified as fixed commodity costs. Because these particular supply costs have been incurred to provide an amount of annual reliable system yield and not to provide peak demand delivery capability or standby service they are reasonably treated as fixed commodity costs.

Costs for the Conveyance and Aqueduct (C&A) service function are classified into demand, commodity, and standby categories. Because the capital costs for C&A were incurred to meet all three classification categories, an analysis of C&A capacity usage for the ten years ending June 2008 was used to determine that 67 percent of the available conveyance capacity has been used to meet member agency demands on an average annual basis. A system peak factor<sup>1</sup> of 1.5 was applied to the average annual usage to determine that 33 percent of available capacity is used to meet peak monthly deliveries to the member agencies, while 2 percent is used for standby. The same classification percentages are applied to the CRA, SWP, and Other (Inland Feeder) Conveyance and Aqueduct sub-functions. The classification shares reflect the system average use of conveyance capacity and not the usage of individual facilities. All of the Conveyance and Aqueduct energy costs for pumping water to Southern California are classified as variable commodity costs and, therefore, are not shown in Schedule 6 because they carry through the classification step.

Storage service function costs for emergency, drought and regulatory storage are also distributed to the classification categories based on the type of service provided. Emergency storage costs are classified as 100 percent standby related. Emergency storage is a prime example of a cost Metropolitan incurs to ensure the reliability of deliveries to the member agencies. In effect, through the emergency storage capacity in the system, Metropolitan is "standing by" to provide service in the event of a catastrophe such as a major earthquake that disrupts regional conveyance capacity for an extended period of time. Drought carryover storage serves to provide reliable supplies by carrying over surplus supplies from periods of above normal precipitation and snow pack to drought periods when supplies decrease. Drought storage creates supply and is one component of the portfolio of resources that result in a reliable amount of annual system supplies. As a result, drought storage is classified as a fixed commodity cost, in the same manner as Metropolitan's supply costs. Regulatory storage within the Metropolitan system provides operational flexibility in meeting peak demands and flow requirements, essentially increasing the physical distribution capacity. Therefore, regulatory storage is classified in the same manner as distribution costs.

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<sup>1</sup> Peak monthly deliveries to the member agencies average about 50 percent more than the average monthly deliveries.

Distribution service function costs were classified using daily flow data for the three calendar years ending December 2006. During this period, the average annual volume of deliveries to the member agencies used 52 percent of the peak distribution capacity. The difference between the average flow and system capacity, or 48 percent of the distribution capacity, was used to meet peak day demands in excess of average annual flows. Although the Metropolitan distribution system has a great deal of operational flexibility, the total amount of distribution capacity was limited to the peak non-coincident<sup>2</sup> 24-hour daily flow of all the member agencies.

As presented in Schedule 6, treatment service function costs were also classified using daily flow data of deliveries to the member agencies for the ten years ending December 2008. Total treated water capacity of 4,204 cfs, the total design capacity of all the treatment plants, was used in the calculation. Schedule 7 summarizes the service function revenue requirements by classification category. Administrative and general costs have been allocated to the classification categories by service function based on the ratio of classified non-A&G service function costs to total non-A&G service function costs.

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<sup>2</sup> The term “non-coincident” means that the peak day flow for each agency may or may not coincide with the peak day system flow. Both non-coincident and coincident approaches to measuring peak demands are used in rate design approaches. A non-coincident approach is used in the rate design to capture the different operating characteristics of the member agencies (e.g., the distribution system is designed to meet peak demands in different load areas within the System that have non-coincident demands due to each member agencies unique operating characteristics).

**Schedule 6. Classification Percentages**

Function	Classification Percentages			Total % Classified	Comments
	Fixed				
	Commodity	Demand	Standby		
<b>Source of Supply</b>					
Colorado River Aqueduct	100%	0%	0%	100%	Supply costs classified as commodity
State Water Project	100%	0%	0%	100%	Supply costs classified as commodity
<b>Conveyance &amp; Aqueduct</b>					
Colorado River Aqueduct	67%	33%	0%	100%	Demand (peaking) percentage represents application of system monthly peak factor of 1.5 to average monthly flow. Commodity percentage represents average flows. Remainder of capacity is for standby (expected growth). SWP and CRA are treated the same due to application of system wide uniform price.
State Water Project	67%	33%	0%	100%	
Other	67%	33%	0%	100%	
<b>Storage</b>					
Emergency	0%	0%	100%	100%	Standby service (recovered by RTS)
Drought	100%	0%	0%	100%	Recovered by Supply Contract
Regulatory	52%	48%	0%	100%	See distribution (below)
<b>Treatment</b>	45%	55%	0%	100%	Demand percentage represents amount of system treatment capacity used to meet peak day flows in excess of average. Commodity percentage represents amount of capacity used to meet average flows. Standby percentage is estimated as remaining total capacity. The same classification is applied to all five treatment plants due to the use of a uniform system wide treatment surcharge.
<b>Distribution</b>	52%	48%	0%	100%	Demand percentage represents amount of system distribution capacity used to meet peak day flows in excess of average. Commodity percentage represents amount of capacity used to meet average flows. Standby percentage is estimated as remaining total system capacity. The same classification is applied to all distribution facilities due to the use of a system wide uniform system access rate.

Totals may not foot due to rounding

A summary of cost classification results is shown in Schedule 7. The classification of the service function costs results in about 9 percent, or \$118.4 million of the total revenue requirements, being allocated to the demand classification category. This amount represents a reasonable estimate of the annual fixed capital financing costs incurred to meet peak demands (plus the allocated administrative and general costs). A portion of Metropolitan's property tax revenue is allocated to C&A fixed demand costs and offsets the amount that is recovered through rates. The taxes are used to pay for the general obligation bond debt service allocated to the C&A costs.

**Schedule 7. Service Function Revenue Requirements (by classification category)**

Functional Categories (by sub-Fuction)	Fixed Demand	Commodity	Standby	Variable Commodity	Hydroelectric	Total Classified
<b>Source of Supply</b>						
CRA	\$ -	\$ 40,876,286	\$ -	\$ -	\$ -	\$ 40,876,286
SWP	-	181,097,672	-	-	-	181,097,672
Other Supply	-	16,248,454	-	-	-	16,248,454
<b>Subtotal: Source of Supply</b>	-	238,222,412	-	-	-	<b>238,222,412</b>
<b>Conveyance &amp; Aqueduct</b>						
CRA						
<i>CRA Power</i>	-	5,368,293	-	35,541,686	-	40,909,979
<i>CRA All Other</i>	3,142,559	38,236,607	-	-	-	41,379,166
SWP						
<i>SWP Power</i>	-	986,989	-	219,846,907	-	220,833,896
<i>SWP All Other</i>	15,958,874	166,395,685	-	-	-	182,354,559
Other Conveyance & Aqueduct	15,598,483	41,178,291	-	-	-	56,776,773
<b>Subtotal: Conveyance &amp; Aqueduct</b>	34,699,916	252,165,864	-	255,388,593	-	<b>542,254,373</b>
<b>Storage</b>						
Storage Costs Other Than Power						
<i>Emergency</i>	-	-	65,293,025	-	-	65,293,025
<i>Drought</i>	-	56,134,844	-	-	-	56,134,844
<i>Regulatory</i>	5,304,205	7,805,077	-	-	-	13,109,283
Storage Power	-	-	-	(1,034,126)	-	(1,034,126)
<b>Subtotal: Storage</b>	5,304,205	63,939,921	65,293,025	(1,034,126)	-	<b>133,503,025</b>
<b>Water Quality</b>						
CRA	-	-	-	-	-	-
SWP	-	-	-	-	-	-
Other	-	-	-	-	-	-
<b>Subtotal: Water Quality</b>	-	-	-	-	-	-
<b>Treatment</b>	51,262,510	137,699,707	-	39,286,894	-	<b>228,249,111</b>
<b>Distribution</b>	27,175,551	94,680,995	-	-	-	<b>121,856,546</b>
<b>Demand Management</b>	-	70,001,526	-	-	-	<b>70,001,526</b>
<b>Hydroelectric</b>	-	-	-	-	(14,219,374)	<b>(14,219,374)</b>
<b>Total Costs Classified</b>	\$ 118,442,181	\$ 856,710,425	\$ 65,293,025	\$ 293,641,361	\$ (14,219,374)	\$ 1,319,867,618

Totals may not foot due to rounding

About 65 percent of the revenue requirement (\$857 million) is classified as “fixed commodity”. These fixed capital and operating costs are incurred by Metropolitan to meet annual average service needs and are typically recovered by a combination of fixed charges and volumetric rates. Fixed capital costs classified to the “Standby” category total about \$65 million and account for about 5 percent of the revenue requirements. Standby service costs are commonly recovered by a fixed charge allocated on a reasonable representation of a customer’s need for standby service. The variable commodity costs for power on the conveyance and aqueduct systems, and power, chemicals and solids handling at the treatment plants change with the amount of water delivered to the member agencies. These costs are classified as variable commodity costs, total about \$294 million, and account for about 22.2 percent of the total revenue requirement. Because of the variable nature of these costs, it is appropriate to recover them through volumetric rates.

## **2 Rates and Charges**

Schedule 8 provides a cross-reference between the classified service function costs and their allocation to the rate design elements. The specifics of each rate design element are discussed in detail in the following section. Schedule 9 summarizes the rates and charges to be effective January 1, 2009. Average costs by member agency will vary depending upon an agency’s RTS allocation, capacity charge and relative proportions of treated and untreated Tier 1, Tier 2, Replenishment, and Interim Agricultural Water Program purchases.

**Schedule 8. Classified Service Function Revenue Requirements (by rate design element)**

Service Function by Classification Category	Rate Design Elements							Total Costs Allocated
	Supply Rates	System Access Rate	Water Stewardship Rate	System Power Rate	Capacity Charge	Readiness-to-Serve Charge	Treatment Surcharge	
<b>Supply</b>								
Fixed Demand	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Fixed Commodity	238,222,412	-	-	-	-	-	-	238,222,412
Fixed Standby	-	-	-	-	-	-	-	-
Variable Commodity	-	-	-	-	-	-	-	-
Hydroelectric	-	-	-	-	-	-	-	-
<b>Subtotal: Supply</b>	238,222,412	-	-	-	-	-	-	238,222,412
<b>Conveyance and Aqueduct</b>								
Fixed Demand	-	-	-	-	-	34,699,916	-	34,699,916
Fixed Commodity	-	252,165,864	-	-	-	-	-	252,165,864
Fixed Standby	-	-	-	-	-	-	-	-
Variable Commodity	-	-	-	255,388,593	-	-	-	255,388,593
Hydroelectric	-	-	-	-	-	-	-	-
<b>Subtotal: Conveyance and Aqueduct</b>	-	252,165,864	-	255,388,593	-	34,699,916	-	542,254,373
<b>Storage</b>								
Fixed Demand	-	-	-	-	5,304,205	-	-	5,304,205
Fixed Commodity	56,134,844	7,805,077	-	-	-	-	-	63,939,921
Fixed Standby	-	-	-	-	-	65,293,025	-	65,293,025
Variable Commodity	(1,034,126)	-	-	-	-	-	-	(1,034,126)
Hydroelectric	-	-	-	-	-	-	-	-
<b>Subtotal: Storage</b>	55,100,717	7,805,077	-	-	5,304,205	65,293,025	-	133,503,025
<b>Water Quality</b>								
Fixed Demand	-	-	-	-	-	-	-	-
Fixed Commodity	-	-	-	-	-	-	-	-
Fixed Standby	-	-	-	-	-	-	-	-
Variable Commodity	-	-	-	-	-	-	-	-
Hydroelectric	-	-	-	-	-	-	-	-
<b>Subtotal: Water Quality</b>	-	-	-	-	-	-	-	-
<b>Treatment</b>								
Fixed Demand	-	-	-	-	-	-	51,262,510	51,262,510
Fixed Commodity	-	-	-	-	-	-	137,699,707	137,699,707
Fixed Standby	-	-	-	-	-	-	-	-
Variable Commodity	-	-	-	-	-	-	39,286,894	39,286,894
Hydroelectric	-	-	-	-	-	-	-	-
<b>Subtotal: Treatment</b>	-	-	-	-	-	-	228,249,111	228,249,111
<b>Distribution</b>								
Fixed Demand	-	-	-	-	27,175,551	-	-	27,175,551
Fixed Commodity	-	94,680,995	-	-	-	-	-	94,680,995
Fixed Standby	-	-	-	-	-	-	-	-
Variable Commodity	-	-	-	-	-	-	-	-
Hydroelectric	-	(14,219,374)	-	-	-	-	-	(14,219,374)
<b>Subtotal: Distribution</b>	-	80,461,621	-	-	27,175,551	-	-	107,637,172
<b>Demand Management</b>								
Fixed Demand	-	-	-	-	-	-	-	-
Fixed Commodity	-	-	70,001,526	-	-	-	-	70,001,526
Fixed Standby	-	-	-	-	-	-	-	-
Variable Commodity	-	-	-	-	-	-	-	-
Hydroelectric	-	-	-	-	-	-	-	-
<b>Subtotal: Demand Management</b>	-	-	70,001,526	-	-	-	-	70,001,526
<b>Total</b>								
Fixed Demand	-	-	-	-	32,479,756	34,699,916	51,262,510	118,442,181
Fixed Commodity	294,357,256	354,651,937	70,001,526	-	-	-	137,699,707	856,710,425
Fixed Standby	-	-	-	-	-	65,293,025	-	65,293,025
Variable Commodity	(1,034,126)	-	-	255,388,593	-	-	39,286,894	293,641,361
Hydroelectric	-	(14,219,374)	-	-	-	-	-	(14,219,374)
<b>Total</b>	<b>\$ 293,323,130</b>	<b>\$ 340,432,563</b>	<b>\$ 70,001,526</b>	<b>\$ 255,388,593</b>	<b>\$ 32,479,756</b>	<b>\$ 99,992,941</b>	<b>\$ 228,249,111</b>	<b>\$ 1,319,867,618</b>

Totals may not foot due to rounding

**Schedule 9. Rates and Charges Summary**

	<b>Effective January 1, 2008</b>	<b>Effective January 1, 2009</b>
Tier 1 Supply Rate (\$/AF)	\$73	\$109
Tier 2 Supply Rate (\$/AF)	\$171	\$250
Water Supply Surcharge (\$/AF)	-	\$25
System Access Rate (\$/AF)	\$143	\$143
Water Stewardship Rate (\$/AF)	\$25	\$25
System Power Rate (\$/AF)	\$110	\$110
Full Service Untreated Volumetric Cost (\$/AF)		
Tier 1	\$351	\$412
Tier 2	\$449	\$528
Replenishment Water Rate Untreated (\$/AF)	\$258	\$294
Interim Agricultural Water Program Untreated (\$/AF)	\$261	\$322
Treatment Surcharge (\$/AF)	\$157	\$167
Full Service Treated Volumetric Cost (\$/AF)		
Tier 1	\$508	\$579
Tier 2	\$606	\$695
Treated Replenishment Water Rate (\$/AF)	\$390	\$436
Treated Interim Agricultural Water Program (\$/AF)	\$394	\$465
Readiness-to-Serve Charge (\$M)	\$82	\$92
Capacity Charge (\$/cfs)	\$6,800	\$6,800

### **2.1 System Access Rate (SAR)**

The SAR is a volumetric<sup>3</sup> system-wide rate levied on each acre-foot of water that moves through the MWD system. All system users (member agency or third party) pay the SAR to use Metropolitan's conveyance and distribution system. It is recommended that the SAR remain at its current level of \$143 per acre-foot. The SAR recovers the cost of providing conveyance and distribution capacity to meet average annual demands. Current estimates indicate that the SAR revenue requirement will be about \$340 million in FY 2008/09, 25.8 percent of the total revenue requirement.

### **2.2 Water Stewardship Rate (WSR)**

It is recommended that the WSR remain at its current level of \$25 per acre-foot. The WSR recovers the costs of providing financial incentives for existing and future investments in local resources including conservation and recycled water. These investments or incentive payments are identified as the "demand management" service function in the cost of service process. Demand management costs are classified as 100 percent fixed commodity costs and are estimated to be about \$70 million in FY 2008/09, about 5.3 percent of the revenue requirement. The WSR is a volumetric rate levied on each acre-foot of water that moves through the Metropolitan system. All system users (member agency or third parties) will pay the same proportional costs for existing and future conservation and recycling investments. Given balances in the Water Stewardship Fund, it is recommended that the WSR remain unchanged in 2008, and \$15.2 million be withdrawn from the Water Stewardship Fund to offset costs not fully recovered from the WSR.

### **2.3 System Power Rate (SPR)**

The recommended SPR remains at \$110 per acre-foot in 2009. The SPR is a volumetric rate that recovers the costs of pumping water to Southern California. The SPR recovers the cost of power for both the SWP and CRA. In FY 2008/09 the revenue requirement for the SPR is estimated to be about \$255 million, about 19.3 percent of the total revenue requirement.

### **2.4 Treatment Surcharge**

It is recommended that the treatment surcharge be increased from its current level of \$157 per acre-foot to \$167 per acre-foot effective January 1, 2009. The treatment surcharge is a system-wide volumetric rate set to recover the cost of providing treated water service. The treatment surcharge revenue requirement is expected to be about \$228 million in FY 2008/09, almost 17.3 percent of the total revenue requirement. The treatment surcharge recovers all costs associated with providing treated water service, including commodity, demand and standby related costs. The increase in the treatment surcharge is necessary to cover capital financing costs allocated to the treatment surcharge. Significant capital improvements at Metropolitan's five treatment plants, such as the Ozone Retrofit Program, Skinner Filtration Plant Expansion Project, and improvement programs at all five treatment plants result in additional capital financing costs being allocated to the treatment surcharge.

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<sup>3</sup> A volumetric rate is a charge applied to the actual amount of water delivered.

## **2.5 Capacity Charge**

It is recommended that the Capacity Charge remain unchanged at its current level of \$6,800 per cubic-foot-second of capacity used effective January 1, 2009. The capacity charge is levied on the maximum summer day demand placed on the system between May 1 and September 30 for a three-calendar year period. The three-year period ending December 31, 2007 is used to levy the capacity charge effective January 1, 2009 through December 31, 2009. Demands measured for the purposes of billing the capacity charge include all firm demand and agricultural demand, including wheeling service and exchanges. Replenishment service is not included in the measurement of peak day demand for purposes of billing the capacity charge.

The capacity charge is intended to pay for the cost of peaking capacity on Metropolitan's system, while providing an incentive for local agencies to decrease their use of the Metropolitan system to meet peak day demands and to shift demands into lower use time periods particularly October through April. Over time, a member agency will benefit from local supply investments and operational strategies that reduce its peak day demand on the system in the form of a lower total capacity charge. The estimated capacity charge to be paid by each member agency in calendar year 2009 (as of February 2008) is included in Schedule 10.

**Schedule 10. Calendar Year 2009 Capacity Charge**

AGENCY	Peak Day Demand (cfs) (May 1 through September 30) Calendar Year				3-Year Peak	Calendar Year 2009 Capacity Charge (\$6,800/cfs)
	2005	2006	2007			
Anaheim	60.0	36.6	37.9	60.0	\$	408,000
Beverly Hills	31.9	33.2	33.9	33.9		230,520
Burbank	36.1	35.0	33.7	36.1		245,480
Calleguas	263.8	253.5	260.8	263.8		1,793,840
Central Basin	125.9	130.7	125.9	130.7		888,760
Compton	7.7	7.3	7.1	7.7		52,360
Eastern	236.3	248.6	302.1	302.1		2,054,280
Foothill	23.2	25.3	25.4	25.4		172,720
Fullerton	34.2	32.7	36.9	36.9		250,920
Glendale	56.7	57.0	54.6	57.0		387,600
Inland Empire	132.3	113.8	176.2	176.2		1,198,160
Las Virgenes	43.6	44.8	45.3	45.3		308,040
Long Beach	72.9	56.5	61.3	72.9		495,720
Los Angeles	540.4	540.7	768.5	768.5		5,225,800
MWDOC	438.4	463.6	452.4	463.6		3,152,480
Pasadena	58.3	66.9	58.5	66.9		454,920
San Diego <sup>1</sup>	1064.8	1056.9	1177.5	1,296.0		8,812,800
San Fernando		0.1	6.5	6.5		44,200
San Marino	5.9	8.3	5.2	8.3		56,440
Santa Ana	29.9	30.7	29.7	30.7		208,760
Santa Monica	27.1	27.8	27.6	27.8		189,040
Three Valleys	156.5	155.7	171.4	171.4		1,165,520
Torrance	42.1	41.8	41.6	42.1		286,280
Upper San Gabriel	35.8	42.3	63.8	63.8		433,840
West Basin	276.5	275.8	262.3	276.5		1,880,200
Western	273.5	291.1	288.5	291.1		1,979,480
<b>Total</b>	<b>4,073.8</b>	<b>4,076.7</b>	<b>4,554.6</b>	<b>4,761.2</b>	<b>\$</b>	<b>32,376,160</b>

(1) San Diego capacity set at 1,296 cfs per surface storage operating agreement terms  
Totals may not foot due to rounding

**2.6 Readiness-to-Serve Charge**

The costs of providing standby service, such as emergency storage, are recovered by the RTS. Metropolitan’s cost for providing emergency storage capacity within the system are estimated to be about \$65.3 million in FY 2008/09. In addition, to simplify the rate design by reducing the number of separate charges, the demand and standby related costs identified for the conveyance and aqueduct service function are also allocated to the RTS. These costs are estimated to be about \$34.7 million in FY 2008/09. Currently the RTS recovers \$82 million, an amount that represents a portion of the capital financing costs for facilities that serve existing users. It is recommended that the RTS be increased to \$92 million in 2009 to recover the additional costs associated with emergency storage and conveyance.

The RTS is allocated to the member agencies based on each agency’s proportional share of a ten-year rolling average of all firm deliveries (including water transfers and exchanges that use Metropolitan system capacity). The ten-year rolling average will not include replenishment service and interim

agricultural deliveries because these deliveries will be the first to be curtailed in the event of an emergency. A ten-year rolling average leads to a relatively stable RTS allocation that reasonably represents an agency's potential long-term need for standby service under different demand conditions. Member agencies that so choose may have a portion of their total RTS obligation offset by standby charge collections levied by Metropolitan on behalf of the member agency. Schedule 11 provides an estimate as of February 2008 of each agency's total RTS obligation for FY 2008/09.

**Schedule 11. Readiness-to-Serve Charge (by member agency)**

Member Agency	Rolling Ten-Year Average Firm Deliveries (Acre-Feet) FY1996/97 - FY2005/06	RTS Share	6 months @ \$82 million per year (7/08-12/08)	Rolling Ten-Year Average Firm Deliveries (Acre-Feet) FY1997/98 - FY2006/07	RTS Share	6 months @ \$92 million per year (1/09-6/09)	Total RTS Charge
Anaheim	19,889	1.16%	473,862	20,553	1.16%	534,641	1,008,504
Beverly Hills	13,096	0.76%	312,015	13,008	0.74%	338,374	650,390
Burbank	12,692	0.74%	302,378	12,816	0.72%	333,377	635,755
Calleguas MWD	105,716	6.14%	2,518,665	108,372	6.13%	2,819,092	5,337,757
Central Basin MWD	64,296	3.74%	1,531,837	64,254	3.63%	1,671,447	3,203,283
Compton	3,515	0.20%	83,740	3,514	0.20%	91,400	175,140
Eastern MWD	75,357	4.38%	1,795,373	81,593	4.61%	2,122,492	3,917,865
Foothill MWD	10,691	0.62%	254,705	10,860	0.61%	282,496	537,200
Fullerton	8,837	0.51%	210,528	9,072	0.51%	235,987	446,515
Glendale	25,523	1.48%	608,082	25,094	1.42%	652,767	1,260,849
Inland Empire Utilities Agency	53,818	3.13%	1,282,207	54,273	3.07%	1,411,819	2,694,026
Las Virgenes MWD	21,684	1.26%	516,628	21,987	1.24%	571,952	1,088,580
Long Beach	37,286	2.17%	888,344	37,179	2.10%	967,155	1,855,499
Los Angeles	222,738	12.94%	5,306,706	243,737	13.78%	6,340,368	11,647,074
Municipal Water District of Orange County	223,022	12.96%	5,313,463	223,933	12.67%	5,825,218	11,138,681
Pasadena	21,038	1.22%	501,228	21,742	1.23%	565,571	1,066,799
San Diego County Water Authority	467,634	27.17%	11,141,307	476,270	26.93%	12,389,316	23,530,623
San Fernando	134	0.01%	3,202	119	0.01%	3,085	6,287
San Marino	1,059	0.06%	25,238	1,041	0.06%	27,072	52,310
Santa Ana	12,893	0.75%	307,165	13,062	0.74%	339,782	646,946
Santa Monica	12,458	0.72%	296,815	12,627	0.71%	328,461	625,276
Three Valleys MWD	70,106	4.07%	1,670,264	70,606	3.99%	1,836,677	3,506,941
Torrance	21,241	1.23%	506,074	21,052	1.19%	547,627	1,053,701
Upper San Gabriel Valley MWD	13,227	0.77%	315,120	13,963	0.79%	363,222	678,342
West Basin MWD	143,679	8.35%	3,423,126	143,695	8.13%	3,737,974	7,161,100
Western MWD	59,263	3.44%	1,411,931	63,915	3.61%	1,662,626	3,074,557
<b>MWD Total</b>	<b>1,720,891</b>	<b>100.00%</b>	<b>\$ 41,000,000</b>	<b>1,768,333</b>	<b>100.00%</b>	<b>\$ 46,000,000</b>	<b>\$ 87,000,000</b>

Totals may not foot due to rounding

## **2.7 Purchase Order**

The rate structure relies on a Purchase Order to establish a financial commitment from the member agency to Metropolitan. In return for providing a financial commitment to Metropolitan the member agency may purchase more of its supply at the lower Tier 1 Supply Rate than had it not provided the commitment.

The Purchase Order is voluntarily submitted by the member agency to Metropolitan. Through the Purchase Order the member agency commits to purchase a fixed amount of supply from Metropolitan (the Purchase Order Commitment). The Purchase Order Commitment is determined as a portion of the member agency's historical demands on the Metropolitan system and the term of the Purchase Order.

### Term

The Purchase Order is for a ten-year term beginning January 1, 2003. Ten years was chosen as a balance between the long-term investments Metropolitan makes to secure water supply (many of the supply development agreements Metropolitan commits to are for 20 years or more) and a shorter period that would require less of a commitment from the member agencies. In addition, a ten-year period will most likely allow sufficient time for high and low demand years to average, reducing the likelihood that a member agency will pay for unused water.

### Initial base demand

The maximum annual firm demands since FY 1989/90 through June 30, 2002 are used to establish each member agency's "initial base demand". Firm demands are defined as all deliveries through the Metropolitan system to a member agency excluding replenishment service, interim agricultural service, deliveries made under the interruptible service program and deliveries made to cooperative and cyclic storage accounts at the time water was put into the accounts.

### Purchase Order Commitment

The Purchase Order Commitment is limited to a portion of a member agency's initial base demand. The Purchase Order Commitment is defined as ten times 60 percent of the member agency's initial base demand. The ten times reflects the ten-year term of the Purchase Order and the 60 percent was chosen to balance risk transferred to the member agencies with the need for a financial commitment to Metropolitan.

Two factors influenced the use of the 60 percent demand level. First, there is substantial fluctuation in demands as a result of weather. During cool, wet weather, member agencies use less imported supply from Metropolitan's system. As a result, the Purchase Order Commitment was set at a level that would accommodate these annual fluctuations in weather driven demands, while helping to ensure that member agencies would have a reasonable opportunity to utilize all of the water during the ten-year Purchase Order term. Second, the 60 percent level was selected in consultation with member agency representatives and represents a sufficient incentive to utilize Metropolitan's supplies and provide a base financial commitment to the regional system. Since the Purchase Order Commitment is voluntary, no member agency is required to commit to the minimum level. But, in exchange for the commitment, the member agency may purchase more Metropolitan water supply (up to 90 percent of its Base Demand) at the lower Tier 1 Supply Rate. The Purchase Order Commitment quantity and the Tier 1 Annual Limit for all member agencies are shown in Schedule 12.

**Schedule 12. Purchase Order Commitment Quantities (acre-feet)**

	<b>Tier 1 Annual Limit</b>	<b>Purchase Order Commitment (acre-feet)</b>
Anaheim	22,240	148,268
Beverly Hills	13,380	89,202
Burbank	16,336	108,910
Calleguas	103,801	692,003
Central Basin	72,361	482,400
Compton	5,058	33,721
Eastern	75,700	504,664
Foothill	10,997	73,312
Fullerton	11,298	75,322
Glendale	26,221	174,809
Inland Empire	59,752	398,348
Las Virgenes	20,565	137,103
Long Beach	39,471	263,143
Los Angeles	304,970	2,033,132
MWDOC	222,924	1,486,161
Pasadena	21,180	141,197
San Diego	501,386	3,342,571
San Fernando	630	-
San Marino	1,199	-
Santa Ana	12,129	80,858
Santa Monica	11,364	74,062
Three Valleys	70,400	469,331
Torrance	20,967	139,780
Upper San Gabriel	16,512	110,077
West Basin	156,874	1,045,825
Western	58,769	391,791
<b>Total</b>	<b>1,876,482</b>	<b>12,495,989</b>

Totals may not foot due to rounding

**2.8 Tier 2 supply rate**

The Tier 2 Supply Rate is set at Metropolitan’s cost of developing long-term firm supplies to encourage the member agencies and their customers to maintain existing local supplies and develop cost-effective local supply resources and conservation. The Tier 2 Supply Rate also recovers a greater proportion of the cost of developing additional supplies from member agencies that have increasing demands on the Metropolitan system. Because of the uncertainty about supply and critically dry conditions, Metropolitan will have to purchase more than 200 thousand acre-feet of water transfers in 2008/09, at an expected average cost of \$250 per acre-foot. Hence, it is recommended that the Tier 2 Supply Rate effective January 1, 2009 increase from its current level of

\$171 per acre-foot, to \$250 per acre-foot in order to reflect the much higher costs of acquiring the additional supply.

The total revenue requirement for the supply service function is about \$293 million in FY 2008/09. At an expected average sales level of 2.23 million acre-feet it is estimated that about 192 thousand acre-feet will be sold at the Tier 2 Supply Rate, resulting in about \$33 million in revenues at the \$171 per acre-foot rate in effect during 2008. Tier 2 revenues at the higher rate will not be realized until fiscal year 2009/10. The remaining supply costs are recovered by the Tier 1 Supply Rate and by the replenishment rate and agricultural water rate discussed below.

The two-tier pricing approach is closely linked to the Purchase Order and a base level of demand. The initial base demand (IBD) is defined as the maximum annual firm demands on the Metropolitan system for the 13 years ending June 30, 2002. Firm demands are defined as all deliveries through the Metropolitan system to a member agency excluding: (1) replenishment service; (2) interim agricultural service; (3) deliveries made under the interruptible service program and (4) deliveries made from cooperative, cyclic and conjunctive use storage accounts not certified under the replenishment program.

Member agencies that submitted a Purchase Order may purchase up to 90 percent of the IBD at the lower Tier 1 Supply Rate. For supply purchases in excess of 90 percent of the IBD the member agency will be charged the higher Tier 2 Supply Rate. Member agencies that do not submit a Purchase Order are charged the higher Tier 2 Supply Rate for supplies that exceed 60 percent of the IBD. Over time the IBD will be compared to a rolling ten-year average of firm demands (not including water transfers and exchanges). The greater of the IBD and the rolling ten-year average of firm demands will be used to set the breakpoint between supply purchases made at the Tier 1 and Tier 2 Supply Rates.

### ***2.9 Tier 1 supply rate***

It is recommended that the Tier 1 Supply Rate effective January 1, 2009 increase from its current level of \$73 per acre-foot, to \$109 per acre-foot. This increase is due to the substantial additional costs of the required additional water transfers, caused by the critically dry conditions and a court imposed cutback in State Water Project deliveries. The Tier 1 Supply Rate recovers the majority of the supply revenue requirement. The Tier 1 Supply Rate is simply calculated as the amount of the total supply revenue requirement that is not recovered by the Tier 2 Supply Rate and a portion of the revenues from the replenishment water rate and agricultural water rate divided by the estimated amount of Tier 1 water sales. At an expected demand level of about 2.23 million acre-feet it is estimated that Metropolitan will sell about 1.8 million acre-feet at the Tier 1 Supply Rate in 2008/09.

### ***2.10 Replenishment and agricultural water rates***

Metropolitan currently provides interruptible service for long-term replenishment operations and agricultural deliveries through the replenishment program and the interim agricultural water program (IAWP). Because of the critically dry conditions and uncertainty about supply, replenishment deliveries are expected to be curtailed in 2008/09. In 2008/09, replenishment deliveries are expected to be cut to zero, and certified agricultural deliveries are expected to be about 127 thousand acre-feet. However, if water supply conditions improve and surplus water becomes available, Metropolitan will

make Replenishment service available to its member agencies at the recommended rates of \$294 per acre-foot for untreated, and \$436 per acre-foot for treated water. Since the additional water transfers in 2008/09 are not purchased for Replenishment purposes, the Replenishment rate will not include the Water Supply Surcharge.

Since the rates and charges were revised in 2003, replenishment and agricultural water rates have increased on a dollar for dollar basis, along with the full-service rates. If that practice were implemented in 2009, untreated rates for the replenishment program and interim agricultural water program would increase by \$36 per acre-foot, to \$294 and \$297 per acre-foot, respectively, while rates for treated replenishment and treated agricultural service would increase by \$46 per acre-foot, to \$436 and \$440 per acre-foot respectively. Revenues, if any, generated by these rates will be used to proportionally reduce the revenue requirement that must be recovered by the System Access Rate, Water Stewardship Rate, System Power Rate, Treatment Surcharge, and Tier 1 Supply Rate.

While staff and the member agencies continue to discuss the rationale and value of the replenishment program, it has been suggested that the methodology for setting these rates be revised in the near term to maintain the relative proportions that replenishment rates had to the Tier 1 rate in 2003. This would result in an untreated replenishment rate of \$277 per acre-foot and a treated rate of around \$390 per acre-foot in 2009. There are several reasons for taking this alternative action:

- a. As water supplies are increasingly scarce, it is important to take advantage of those periods when water in excess of full-service demands is available and store as much as is cost effective.
- b. Variability in future years' water availability is expected to increase, making storage more important.
- c. Metropolitan can fully interrupt replenishment deliveries and groundwater agencies can continue to rely on the basins for supply during dry periods.
- d. Some have argued that since Metropolitan has full discretion over the delivery of replenishment water, these sales should cover the marginal or incremental cost of delivery. As such, the price could be even lower. While the argument does not recognize the value of the facilities being used to deliver the water, it is a cost issue that needs to be discussed.
- e. As Metropolitan works with its member agencies to revise and improve the replenishment program, it may be appropriate to maintain the original relationship to encourage agencies to store more water, particularly during those short-term events when significant quantities may be available for limited times.
- f. Since the 2009 rates are calculated with the assumption that there will be no replenishment sales, the revenue impact of a smaller increase in these rates is zero.

This may be an opportune time to allow member agencies and Metropolitan to evaluate the alternative methods while mitigating revenue and rate impacts over the next two years.

### ***2.11 Water Supply Surcharge***

In light of pumping restrictions imposed by the federal court in response to declining fish populations, Metropolitan will be required to purchase significant amounts of spot market water transfers for at least the next two years, until a near-term delta solution is developed. It is estimated that approximately \$50 million will be expended on these transfers in 2008/09. To recover the cost associated with these purchases, it is recommended that a Water Supply Surcharge of \$25 per acre-foot be added to all purchases of Tier 1 and agricultural deliveries. Since the Tier 2 sales are already priced at \$250 per acre-foot, reflecting the cost of these additional supplies, the Water Supply Surcharge would not be assessed to Tier 2 sales. Further, as described in Section 2.10 above, the

Water Supply Surcharge would not be included in the price of replenishment sales. The need for the Water Supply Surcharge will be evaluated annually, but it is expected that the surcharge would continue to be assessed for the next two years or until there is a near-term delta solution resulting in a lower need for spot market transfers.

### **3 Sales**

Expected water sales are provided in Schedule 13. Staff estimates of water sales used for developing the rate recommendation were based on current member agency demands and information and an expectation that demands will trend to levels expected under normal weather conditions. Since 1989/90, total sales have averaged about 2.00 million acre-feet per year, ranging from a high of around 2.5 million acre-feet in 1989/90 to a low of about 1.5 million acre-feet in 1997/98. In 2006/07 water sales totaled around 2.24 million acre-feet. Water sales in 2007/08 are expected to be about 2.32 million acre-feet.

**Schedule 13. Estimated FY 2009 Deliveries (assuming expected demands)**

	<b>Tier 1</b>	<b>Tier 2</b>	<b>Agricultural</b>	<b>Replenishment</b>	<b>Wheeling</b>	<b>Total</b>
Anaheim	23,384	1,248	-	-	-	24,632
Beverly Hills	13,333	-	-	-	-	13,333
Burbank	13,565	-	-	-	-	13,565
Calleguas	103,168	18,251	6,448	-	-	127,867
Central Basin	67,905	-	-	-	-	67,905
Compton	3,309	-	-	-	-	3,309
Eastern	76,745	29,064	4,539	-	-	110,348
Foothill	11,401	1,239	-	-	-	12,640
Fullerton	13,149	-	7	-	-	13,156
Glendale	21,591	-	-	-	-	21,591
Inland Empire	70,145	5,577	79	-	-	75,801
Las Virgenes	22,919	1,512	182	-	-	24,613
Long Beach	39,287	900	-	-	-	40,187
Los Angeles	293,055	95,258	-	-	-	388,313
MWDOC	225,200	6,664	7,598	-	-	239,462
Pasadena	21,129	2,924	-	-	-	24,053
San Diego	477,460	-	80,998	-	81,811	640,270
San Fernando	300	-	-	-	-	300
San Marino	1,505	997	-	-	-	2,502
Santa Ana	14,062	-	-	-	-	14,062
Santa Monica	10,736	1,959	-	-	-	12,695
Three Valleys	72,600	3,640	75	-	-	76,315
Torrance	20,773	1,016	-	-	-	21,789
Upper San Gabriel	11,818	-	-	-	-	11,818
West Basin	143,593	-	-	-	-	143,593
Western	59,044	21,601	27,749	-	-	108,394
<b>Total</b>	<b>1,831,174</b>	<b>191,850</b>	<b>127,676</b>	<b>-</b>	<b>81,811</b>	<b>2,232,511</b>

Totals may not foot due to rounding

**4 Proof of Revenue**

Based on expected sales of 2.23 MAF the expected revenues would be about \$64 million less than the total revenue requirement if the rates and charges were in effect the entire test year period. However, because the recommended rates do not take effect until January 1, 2009 the expected revenues for 2008/09 will be about \$173 million (13 percent) less than total estimated expenditures in 2008/09. The shortfall will be funded from the Water Rate Stabilization Fund.

**Schedule 14. FY 2008/09 Proof of Revenue if Rates Effective for Full Test Year (\$ millions)**

	Revenues if Rates Effective May 1	Revenue Requirements	Difference	% Over Collected
Supply	305.7	293.3	12.3	4%
System Access Rate	314.2	340.4	(26.3)	-8%
Water Stewardship Rate	54.9	70.0	(15.1)	-22%
System Power Rate	241.7	255.4	(13.7)	-5%
Treatment Surcharge	214.9	228.2	(13.4)	-6%
Readiness-to-serve Charge	92.0	100.0	(8.0)	-8%
Capacity Charge	32.4	32.5	(0.1)	0%
<b>Total</b>	<b>1,255.7</b>	<b>1,319.9</b>	<b>(64.2)</b>	<b>-5%</b>

Totals may not foot due to rounding

**Schedule 15. FY 2008/09 Proof of Revenue if Rates Effective January 1 (\$ millions)**

	Revenues if Rates Effective Jan 1	Revenue Requirements	Difference	% Over Collected
Supply	207.3	293.3	(86.1)	-29%
System Access Rate	313.6	340.4	(26.8)	-8%
Water Stewardship Rate	54.8	70.0	(15.2)	-22%
System Power Rate	241.3	255.4	(14.1)	-6%
Treatment Surcharge	205.1	228.2	(23.1)	-10%
Readiness-to-serve Charge	87.0	100.0	(13.0)	-13%
Capacity Charge	32.7	32.5	0.2	1%
<b>Total</b>	<b>1,141.8</b>	<b>1,319.9</b>	<b>(178.1)</b>	<b>-13%</b>

Totals may not foot due to rounding

THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA

RESOLUTION \_\_\_\_

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**RESOLUTION OF THE BOARD OF DIRECTORS  
OF THE METROPOLITAN WATER DISTRICT OF  
SOUTHERN CALIFORNIA  
FIXING AND ADOPTING  
A READINESS-TO-SERVE CHARGE**

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WHEREAS, at its meeting on October 16, 2001, the Board of Directors (“Board”) of The Metropolitan Water District of Southern California (“Metropolitan”) approved a rate structure proposal described in Board Letter 9-6 dated October 16, 2001, including a readiness-to-serve charge; and

WHEREAS, providing firm revenue sources is a goal of such rate structure; and

WHEREAS, the amount of revenue to be raised by the readiness-to-serve charge shall be as determined by the Board and allocation of the readiness-to-serve charge among member public agencies shall be in accordance with the method established by the Board; and

WHEREAS, the readiness-to-serve charge is a charge imposed by Metropolitan upon its member agencies, and is not a fee or charge imposed upon real property or upon persons as an incident of property ownership; and

WHEREAS, Metropolitan has legal authority to impose such readiness-to-serve charge as a water rate pursuant to Section 134 of the Metropolitan Water District Act (the “Act”), and as an availability of service charge pursuant to Section 134.5 of the Act; and

WHEREAS, under authority of Sections 133 and 134 of the Act, the Board has the authority to fix the rate or rates for water as will result in revenue which, together with other revenues, will pay Metropolitan’s operating expenses and provide for payment of other costs, including payment of the interest and principal of Metropolitan’s non-tax funded bonded debt; and

WHEREAS, pursuant to Resolution 8329, adopted by the Board on July 9, 1991, proceeds of the readiness-to-serve charge and other revenues from the sale or availability of water are pledged to the payment of Metropolitan’s outstanding revenue bonds issued and revenue bonds to be issued pursuant to Resolution 8329; and

WHEREAS, under authority of Section 134.5 of the Act, a readiness-to-serve charge imposed as an availability of service charge may be collected from the member public agencies within Metropolitan, or may be imposed as a standby charge against individual parcels within Metropolitan’s service area; and

WHEREAS, under such authority, the water standby charge may be imposed on each acre of land or each parcel of land less than an acre within Metropolitan to which water is made available for any purpose by Metropolitan, whether the water is actually used or not; and

WHEREAS, certain member public agencies of Metropolitan have opted in prior fiscal years to provide collection of all or a portion of their readiness-to-serve charge obligation through a Metropolitan water standby charge imposed on parcels within those member agencies; and

WHEREAS, Metropolitan is willing to comply with the requests of member public agencies opting to have Metropolitan continue to levy water standby charges within their respective territories, on the terms and subject to the conditions contained herein; and

WHEREAS, the readiness-to-serve charge applicable to each member public agency, the method of its calculation, and the specific data used in its determination are as specified in the Engineer's Report dated December 2007 (the "Engineer's Report"), on file with the Board Executive Secretary.

WHEREAS, by Resolution 9055, adopted at its meeting held January 8, 2008, Metropolitan's Board resolved and determined that Metropolitan should develop a reliable source of revenues less susceptible to seasonal and annual variation, through imposition of a readiness-to-serve charge to be collected from Metropolitan's member public agencies, and that the readiness-to-serve charge should be in an amount sufficient to provide for payment of debt service and other appropriately allocated costs, for capital expenditures for projects needed to provide standby and emergency storage service needs; and

WHEREAS, notice was given by Resolution 9055 to the public and to each member public agency of The Metropolitan Water District of Southern California of the intention of Metropolitan's Board to consider and take action at its regular meeting to be held on March 11, 2008, on the Board's intent to impose a readiness-to-serve charge as described in Resolution 9055; and

WHEREAS, the Business and Finance Committee of the Board conducted a public hearing at its regular meeting on February 11, 2008, at which interested parties were given the opportunity to present their views regarding the readiness-to-serve charge and the Engineer's Report; and

WHEREAS, notice of the proposed readiness-to-serve charge and of a public hearing on the date and at the time and location specified in Resolution 9055 was published prior to the hearing in various newspapers of general circulation within Metropolitan's service area; and

WHEREAS, each of the meetings of the Board were conducted in accordance with the Brown Act (commencing at Section 54950 of the Government Code), for which due notice was provided and at which quorums were present and acting throughout;

NOW, THEREFORE, the Board of Directors of The Metropolitan Water District of Southern California does hereby resolve, determine and order as follows:

**Section 1.** That the Board of Directors of Metropolitan hereby fixes and adopts a readiness-to-serve charge for the period from July 1, 2008 through December 31, 2009.

**Section 2.** That said readiness-to-serve charge shall be in an amount sufficient to provide for payment of debt service and other appropriately allocated costs, for capital expenditures for projects needed to provide standby and emergency storage service needs.

**Section 3.** That such readiness-to-serve charge for July 1, 2008 through and including December 31, 2008 shall be a water rate equal to \$47.65 per acre-foot and for January 1, 2009 through and including December 31, 2009 shall be a water rate equal to \$52.03 per acre-foot, which shall be charged on a historic basis for each acre-foot of water, excluding water used for purposes of replenishing local storage and agriculture as defined by the Administrative Code, included in Metropolitan's average water deliveries to its

member agencies for the applicable ten-year period identified in Section 8 below. The aggregate readiness-to-serve charge for the period from July 1, 2008 through and including December 31, 2008 shall be \$41,000,000 and for the period from January 1, 2009 through and including December 31, 2009 shall be \$92,000,000.

**Section 4.** That in the alternative, and without duplication, the readiness-to-serve charge shall be an availability of service charge pursuant to Section 134.5 of the Act.

**Section 5.** That the readiness-to-serve charge for July 1, 2008 through December 31, 2008 shall be allocated among the member public agencies in proportion to the average of deliveries through Metropolitan's system (in acre-feet) to each member public agency during the ten-year period ending June 30, 2006, and the readiness-to-serve charge for January 1, 2009 through December 31, 2009 shall be allocated among the member public agencies in proportion to the average of deliveries through Metropolitan's system (in acre-feet) to each member public agency during the ten-year period ending June 30, 2007. Metropolitan sales of reclaimed water under the Local Projects Program, groundwater under the Groundwater Recovery Program, and deliveries under the Replenishment and Interim Agricultural Water Service Programs are not included in the readiness-to-serve charge water sales calculation. The allocation of the readiness-to-serve charge among member agencies is based on sales data recorded by Metropolitan and shall be conclusive in the absence of manifest error.

The amount of the readiness-to-serve charge to be imposed on each member public agency effective July 1, 2008, is as follows:

**Table 1**  
**Readiness-To-Serve Charge**

<b>Member Agency</b>	<b>Rolling Ten-Year Average Firm Deliveries (Acre-Feet) FY1996/97 - FY2005/06</b>	<b>RTS Share</b>	<b>6 months @ \$82 million per year (7/08-12/08)</b>	<b>Rolling Ten-Year Average Firm Deliveries (Acre-Feet) FY1997/98 - FY2006/07</b>	<b>RTS Share</b>	<b>12 months @ \$92 million per year (1/09-12/09)</b>
Anaheim	19,889	1.16%	\$ 473,862	20,457	1.16%	\$ 1,064,421
Beverly Hills	13,096	0.76%	312,015	13,008	0.74%	676,816
Burbank	12,692	0.74%	302,378	12,816	0.72%	666,821
Calleguas MWD	105,716	6.14%	2,518,665	108,372	6.13%	5,638,746
Central Basin MWD	64,296	3.74%	1,531,837	64,254	3.63%	3,343,227
Compton	3,515	0.20%	83,740	3,514	0.20%	182,818
Eastern MWD	75,357	4.38%	1,795,373	81,593	4.61%	4,245,408
Foothill MWD	10,691	0.62%	254,705	10,860	0.61%	565,047
Fullerton	8,837	0.51%	210,528	9,073	0.51%	472,062
Glendale	25,523	1.48%	608,082	25,094	1.42%	1,305,665
Inland Empire Utilities Agency	53,818	3.13%	1,282,207	54,275	3.07%	2,824,009
Las Virgenes MWD	21,684	1.26%	516,628	21,986	1.24%	1,143,940
Long Beach	37,286	2.17%	888,344	37,179	2.10%	1,934,503
Los Angeles	222,738	12.94%	5,306,706	243,737	13.78%	12,682,002
Municipal Water District of Orange County	223,022	12.96%	5,313,463	223,940	12.67%	11,651,937
Pasadena	21,038	1.22%	501,228	21,742	1.23%	1,131,255
San Diego County Water Authority	467,634	27.17%	11,141,307	476,192	26.93%	24,777,030
San Fernando	134	0.01%	3,202	119	0.01%	6,171
San Marino	1,059	0.06%	25,238	1,041	0.06%	54,149
Santa Ana	12,893	0.75%	307,165	13,062	0.74%	679,631
Santa Monica	12,458	0.72%	296,815	12,627	0.71%	656,987
Three Valleys MWD	70,106	4.07%	1,670,264	70,606	3.99%	3,673,721
Torrance	21,241	1.23%	506,074	21,052	1.19%	1,095,364
Upper San Gabriel Valley MWD	13,227	0.77%	315,120	13,963	0.79%	726,517
West Basin MWD	143,679	8.35%	3,423,126	143,695	8.13%	7,476,694
Western MWD	59,263	3.44%	1,411,931	63,905	3.61%	3,325,058
<b>MWD Total</b>	<b>1,720,891</b>	<b>100.00%</b>	<b>\$ 41,000,000</b>	<b>1,768,157</b>	<b>100.00%</b>	<b>\$ 92,000,000</b>

**Section 6.** That the allocation of the readiness-to-serve charge among member agencies set forth in Section 5 above is consistent with the per-acre-foot water rates imposed pursuant to Section 3 above.

**Section 7.** That it is the intent of the Board that water conveyed through Metropolitan's system for the purposes of water transfers, exchanges or other similar arrangements shall be included in the calculation of a member agency's rolling ten-year average firm demands used to allocate the readiness-to-serve charge.

**Section 8.** That the readiness-to-serve charge and the amount applicable to each electing member public agency, the method of its calculation, and the specific data used in its determination are as specified in the General Manager's recommendation on rates and charges to be effective January 1, 2009, which forms the basis of the readiness-to-serve charge. Such recommendation is on file and available for review by interested parties at Metropolitan's headquarters.

**Section 9.** That except as provided in Section 15 below with respect to any readiness-to-serve charge collected by means of a Metropolitan water standby charge, the readiness-to-serve charge shall be due monthly, quarterly or semiannually as agreed upon by Metropolitan and the member agency.

**Section 10.** That such readiness-to-serve charge may, at the request of any member agency which elected to utilize Metropolitan's standby charge as a mechanism for collecting its readiness-to-serve charge obligation in FY 1996/97, be collected by continuing the Metropolitan water standby charge at the same rates imposed in FY 1996/97 upon land within Metropolitan's (and such member public agency's) service area to which water is made available by Metropolitan for any purpose, whether such water is used or not.

**Section 11.** That the proposed water standby charge, if imposed, shall be collected on the tax rolls, together with the *ad valorem* property taxes which are levied by Metropolitan for the payment of pre-1978 voter-approved indebtedness. Any amounts so collected shall be applied as a credit against the applicable member agency's obligation to pay a readiness-to-serve charge. After such member agency's readiness-to-serve charge allocation is fully satisfied, any additional collections shall be credited to other outstanding obligations of such member agency to Metropolitan or future readiness-to-serve obligations of such agency. Notwithstanding the provisions of Section 10 above, any member agency requesting to have all or a portion of its readiness-to-serve charge obligation collected through standby charge levies within its territory as provided herein shall pay any portion not collected through net standby charge collections to Metropolitan within 50 days after Metropolitan issues an invoice for remaining readiness-to-serve charges to such member agency, as provided in Administrative Code Section 4507.

**Section 12.** That on February 11, 2008, the Business and Finance Committee of Metropolitan's Board conducted a public hearing at which interested parties were afforded the opportunity to present their views regarding the readiness-to-serve charge in accordance with Section 4304(c) of Metropolitan's Administrative Code.

**Section 13.** That no failure to collect, and no delay in collecting, any standby charges shall excuse or delay payment of any portion of the readiness-to-serve charge when due. All amounts collected as water standby charges shall be applied solely as credits to the readiness-to-serve charge of the applicable member agency, with any excess collections being carried forward and credited against other outstanding obligations of such member agency to Metropolitan.

**Section 14.** That the readiness-to-serve charge is imposed by Metropolitan as a rate or charge on its member agencies, and is not a fee or charge imposed upon real property or upon persons as incidents of property ownership, and the water standby charge is imposed within the respective territories of electing member agencies as a mechanism for collection of the readiness-to-serve charge. In the event that the water standby charge, or any portion thereof, is determined to be an unauthorized or invalid fee, charge or assessment by a final

judgment in any proceeding at law or in equity, which judgment is not subject to appeal, or if the collection of the water standby charge shall be permanently enjoined and appeals of such injunction have been declined or exhausted, or if Metropolitan shall determine to rescind or revoke the water standby charge, then no further standby charge shall be collected within any member agency and each member agency which has requested imposition of Metropolitan water standby charges as a means of collecting its readiness-to-serve charge obligation shall pay such readiness-to-serve charge obligation in full, as if imposition of such water standby charges had never been sought.

**Section 15.** That the General Manager and the General Counsel are hereby authorized to do all things necessary and desirable to accomplish the purposes of this Resolution, including, without limitation, the commencement or defense of litigation.

**Section 16.** That this Board finds that the readiness-to-serve charge and other charges provided in this Resolution are not defined as a Project under the California Environmental Quality Act ("CEQA") since they involve continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed actions are not subject to CEQA because they involve 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).

**Section 17.** That if any provision of this Resolution or the application to any member agency, property or person whatsoever is held invalid, that invalidity shall not affect other provisions or applications of this Resolution which can be given effect without the invalid portion or application, and to that end the provisions of this Resolution are severable.

**Section 18.** That the General Manager is hereby authorized and directed to take all necessary action to satisfy relevant statutes requiring notice by mailing or by publication.

**Section 19.** That the Board Executive Secretary is hereby directed to transmit a certified copy of this Resolution to the presiding officer of the governing body of each member public agency.

I HEREBY CERTIFY that the foregoing is a full, true and correct copy of a Resolution adopted by the Board of Directors of The Metropolitan Water District of Southern California, at its meeting held on March 11, 2008.

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Board Executive Secretary  
The Metropolitan Water District  
of Southern California

THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA

RESOLUTION \_\_\_\_

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**RESOLUTION OF THE BOARD OF DIRECTORS  
OF THE METROPOLITAN WATER DISTRICT OF  
SOUTHERN CALIFORNIA  
FIXING AND ADOPTING  
A CAPACITY CHARGE  
EFFECTIVE JANUARY 1, 2009**

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WHEREAS, the Board of Directors (“Board”) of The Metropolitan Water District of Southern California (“Metropolitan”), pursuant to Sections 133, 134 and 134.5 of the Metropolitan Water District Act (the “Act”), is authorized to fix such rate or rates for water as will result in revenue which, together with revenue from any water standby or availability of service charge or assessment, will pay the operating expenses of Metropolitan, provide for repairs and maintenance, provide for payment of the purchase price or other charges for property or services or other rights acquired by Metropolitan, and provide for the payment of the interest and principal of its bonded debt; and

WHEREAS, the capacity charge is a fixed fee imposed (on a dollar per cubic-foot-per-second basis) on member agencies on the amount of capacity used by such member agency and is designed to recover the cost of providing peaking capacity within the distribution system; and

WHEREAS, on January 8, 2008, the General Manager presented to the Business and Finance Committee of Metropolitan’s Board his determination of total revenues and of revenues to be derived from water sales and firm revenue sources required during the fiscal year beginning in FY 2007/08, and a detailed report describing each of the rates and charges and the supporting cost of service process, dated December 2006 (the “Report”), that (i) describes the rate structure process and design, (ii) shows the costs of major service functions that Metropolitan provides to its member agencies, (iii) classifies these service functions costs based on the use of the Metropolitan system to create a logical nexus between the revenues required from each of the rates and charges, and (iv) sets forth the rates and charges necessary to defray such costs; and

WHEREAS, on January 8, 2008, the General Manager presented to the Business and Finance Committee his recommendation for rates and charges to be imposed and determination of total revenues to be derived from water sales and firm revenue sources required during the fiscal year beginning in FY 2008/09; and

WHEREAS, by Resolution 9056, adopted at its meeting held January 8, 2008, Metropolitan’s Board resolved and determined that Metropolitan should develop firm net revenues, exclusive of *ad valorem* property taxes, through imposition of a capacity charge, as described in Resolution 9056, to be imposed on Metropolitan’s member public agencies; and

WHEREAS, the Business and Finance Committee of the Board conducted a public hearing at its regular meeting on February 11, 2008, at which interested parties were given the opportunity to present their views regarding the proposed capacity charge; and

WHEREAS, notice of the proposed capacity charge and of a public hearing on the date and at the time and location specified in Resolution 9056 was published prior to the hearing in various newspapers of general circulation within Metropolitan's service area; and

WHEREAS, each of the meetings of the Board were conducted in accordance with the Brown Act (commencing at Section 54950 of the Government Code), for which due notice was provided and at which quorums were present and acting throughout; and

WHEREAS, the amount of revenue to be raised by the capacity charge shall be as determined by the Board and allocation of such charges among member public agencies shall be in accordance with the method established by the Board; and

WHEREAS, the capacity charge is a charge imposed by Metropolitan upon its member agencies, and is not a fee or charge imposed upon real property or upon persons as an incident of property ownership; and

WHEREAS, Metropolitan has legal authority to impose the capacity charge as a water rate pursuant to Sections 133 and 134 of the Metropolitan Water District Act (the "Act"); and

WHEREAS, under authority of Sections 133 and 134 of the Act, the Board has the authority to fix the rate or rates for water as will result in revenue which, together with other revenues, will pay Metropolitan's operating expenses and provide for the payment of other costs, including payment of the interest and principal of Metropolitan's non-tax funded debt; and

WHEREAS, the capacity charge is intended to recover the debt service and other appropriately allocated costs to construct, operate and maintain projects needed to meet peak demands on Metropolitan's distribution system, as shown in the Report; and

WHEREAS, in the alternative under Section 134.5 of the Metropolitan Water District Act, an availability of service charge may be collected from the member public agencies within Metropolitan;

NOW, THEREFORE, the Board of Directors of The Metropolitan Water District of Southern California does hereby resolve, determine and order as follows:

**Section 1.** That the Board of Directors of Metropolitan hereby fixes and adopts a capacity charge, as described below, to be effective January 1, 2009.

**Section 2.** That the capacity charge shall be in an amount sufficient to provide for payment of the capital financing costs not paid from *ad valorem* property taxes, as well as operations, maintenance and overhead costs incurred to provide peaking capacity within Metropolitan's distribution system.

**Section 3.** That such capacity charge effective January 1, 2009 shall be a water rate of \$6,800 per cubic-foot-per-second (set in dollars per cubic-foot-per-second of the peak day capacity) for capacity provided to a member agency.

**Section 4.** That in the alternative, and without duplication, the capacity charge shall be an availability of service charge pursuant to Section 134.5 of the Act.

**Section 5.** That on March 12, 2007, the Business and Finance Committee of Metropolitan’s Board conducted a public hearing at which interested parties were afforded the opportunity to present their views regarding the capacity charge in accordance with Section 4304(c) of Metropolitan’s Administrative Code.

**Section 6.** That this Board finds and determines that the capacity charge is a reasonable fee for use of capacity of Metropolitan’s distribution system.

**Section 7.** That the capacity charge shall be a fixed charge as shown in the following table and collected from each member agency monthly, quarterly or semiannually as agreed to by Metropolitan and the member agency.

**Table 1. Calendar Year 2009 Capacity Charge**

AGENCY	Peak Day Demand (cfs) (May 1 through September 30) Calendar Year				Calendar Year 2009 Capacity Charge (\$6,800/cfs)
	2005	2006	2007	3-Year Peak	
Anaheim	60.0	36.6	37.9	60.0	\$ 408,000
Beverly Hills	31.9	33.2	33.9	33.9	230,520
Burbank	36.1	35.0	33.7	36.1	245,480
Calleguas	263.8	253.5	260.8	263.8	1,793,840
Central Basin	125.9	130.7	125.9	130.7	888,760
Compton	7.7	7.3	7.1	7.7	52,360
Eastern	236.3	248.6	302.1	302.1	2,054,280
Foothill	23.2	25.3	25.4	25.4	172,720
Fullerton	34.2	32.7	36.9	36.9	250,920
Glendale	56.7	57.0	54.6	57.0	387,600
Inland Empire	132.3	113.8	176.2	176.2	1,198,160
Las Virgenes	43.6	44.8	45.3	45.3	308,040
Long Beach	72.9	56.5	61.3	72.9	495,720
Los Angeles	540.4	540.7	768.5	768.5	5,225,800
MWDOC	438.4	463.6	452.4	463.6	3,152,480
Pasadena	58.3	66.9	58.5	66.9	454,920
San Diego <sup>1</sup>	1064.8	1056.9	1177.5	1,296.0	8,812,800
San Fernando		0.1	6.5	6.5	44,200
San Marino	5.9	8.3	5.2	8.3	56,440
Santa Ana	29.9	30.7	29.7	30.7	208,760
Santa Monica	27.1	27.8	27.6	27.8	189,040
Three Valleys	156.5	155.7	171.4	171.4	1,165,520
Torrance	42.1	41.8	41.6	42.1	286,280
Upper San Gabriel	35.8	42.3	63.8	63.8	433,840
West Basin	276.5	275.8	262.3	276.5	1,880,200
Western	273.5	291.1	288.5	291.1	1,979,480
<b>Total</b>	<b>4,073.8</b>	<b>4,076.7</b>	<b>4,554.6</b>	<b>4,761.2</b>	<b>\$ 32,376,160</b>

(1) San Diego capacity set at 1,296 cfs per surface storage operating agreement terms  
Totals may not foot due to rounding

**Section 8.** That the capacity charge for each member public agency, the method of its calculation, cost allocations and other data used in its determination are as specified in the Report, which is on file and available for review by interested parties at Metropolitan’s headquarters.

**Section 9.** That the General Manager and the General Counsel are hereby authorized to do all things necessary and desirable to accomplish the purposes of this Resolution, including, without limitation, the commencement or defense of litigation.

**Section 10.** That this Board finds that the proposed capacity charge is not defined as a Project under the California Environmental Quality Act (“CEQA”) since 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 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).

**Section 11.** That the General Manager is hereby authorized and directed to take all necessary action to satisfy relevant statutes requiring notice by publication.

**Section 12.** That the Board Executive Secretary is hereby directed to transmit a certified copy of this Resolution to the presiding officer of the governing body of each member public agency.

I HEREBY CERTIFY that the foregoing is a full, true and correct copy of a Resolution adopted by the Board of Directors of The Metropolitan Water District of Southern California, at its meeting held on March 11, 2008.

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Board Executive Secretary  
The Metropolitan Water District  
of Southern California