

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

October 14, 2008 Board Meeting

9-2

Subject

Preliminary outlook of the State Water Project calendar year 2009 charges

Description

The Department of Water Resources (DWR) provided Metropolitan its formal notice of calendar year 2009 costs for the State Water Project (SWP). The Statement of Charges (SOC) provides a conservative estimate for DWR to collect necessary revenues and is higher than actual payments during most calendar years, as it does not account for credits, actual delivery costs, and other actions that reduce actual billings. Metropolitan's calendar year 2009 Statement of Charges is \$708 million. As shown in [Attachment 1](#), this is an increase of \$124 million over the final CY 2008 SOC. We expect the 2009 SOC to be reduced in a revision to be issued this December. Authorization to pay the revised SOC will be considered by the Board in December or January.

Projected charges are being reviewed by staff and our outside SWP auditors Richardson and Company. Staff has identified targeted areas and initiated discussions with DWR on current costs totaling \$47 million, as shown in the table that follows. The discussions on costs already identified are expected to lower charges in the revised December invoice. These reductions are estimated at \$7 million representing the share of the Delta solution charges to be paid by Central Valley Project contractors, \$5 million due to a revised transmission tariff, and \$5 million for auditor-requested adjustments. Additional reductions may follow as a result of the discussions with DWR. Metropolitan staff will be initiating discussions with DWR on future capital programs totaling \$1 billion. Included in these discussions are the timing and scope of future capital programs.

At \$330 million, energy is a large component of the \$708 million charge. The \$330 million energy charge is an estimate of costs based on receipt by Metropolitan of 1.7 million acre-feet in 2009. This energy charge has a fixed or core component of \$96 million and supply dependent or variable component of \$234 million. Because our water is projected to be much less than 1.7 MAF due to the drought, our energy costs are likely to be substantially lower. For instance, variable charges for delivery of 600,000 acre-feet, a 15 percent Table A allocation plus groundwater and dry year transfers, would be about \$98 million. If additional supplies become available, variable charges would increase at the rate of about \$16 million for each additional 100,000 acre-feet.

Historically, actual expenditures have usually been lower than the Statement of Charges due to energy and other adjustments, as shown in [Attachment 2](#). For example, the 2008 SOC was \$584 million while the charges, net of credits, is projected to be \$452 million.

The calendar year 2009 increases are in five major categories.

Specific areas of increase are listed below and further explained in [Attachment 3](#) to this letter:

Category	Increased Charges	Charges under review
Energy	\$60 million	\$5 million
Delta solution	\$27 million	\$7 million
Infrastructure	\$19 million	\$10 million
O&M Charges	\$6 million	\$19 million
O&M adjustment	\$12 million	\$6 million
Total	\$124 million	\$47 million

Areas of increase

- Energy charges increased \$60 million to \$330 million. This represents expected charges to meet delivery requests for a full Table A allocation with the expectation of high costs for purchased energy.
- Delta solution charges are for two new programs: (1) the EIR cost for the Delta Habitat Conservation and Conveyance Program and (2) fisheries mitigation measures being considered to address impacts of future Delta pumping. A reduction of \$7 million is anticipated due to CVP contractor contribution for their appropriate share of the DHCCP.
- Infrastructure increases reflect the cost of scheduled capital projects. Metropolitan is discussing with DWR the timing, basis of the projects including the Delta facilities, East Branch Enlargement, and others.
- O&M charges include increased charges for current Delta fisheries mitigation and evaluating replacements for the Reid Gardner power plant.
- O&M adjustments are due mainly for evaporative losses and reservoir storage level changes.

Preliminary Analysis of CY 2009 Statement of Charges

The Statement of Charges is derived from estimates made for the upcoming year. Because DWR issues invoices based on its estimates, corrections and adjustments are made in subsequent years after actual costs are determined. Annually, Metropolitan undertakes an in-depth analysis and audit of the charges. Metropolitan is broadening the scope of this normal review to include analysis of cost trends particularly labor, overhead, consultant, and material costs for the operation and maintenance of the project. A report on the results of this review will accompany the authorization request to pay CY 2009 charges.

Audit of the Statement of Charges

Richardson and Company, Metropolitan's independent State Water Project auditor, is reviewing the CY 2009 Statement of Charges. The findings will be presented to the Audit and Ethics Committee at one of its upcoming meetings prior to the request to authorize payment of the CY 2009 charges.

Future Steps

Staff continues to work with the other contractors and DWR to analyze project costs. To the extent staff believes DWR has erred in its calculation of charges, staff will take appropriate action to cause DWR to make corrections, including possible filing of Claims with the State Controller’s office. In the upcoming months, staff will present the results of the independent audit, and request the Board to consider authorizing the General Manager to make SWP payments beginning in January 2009.

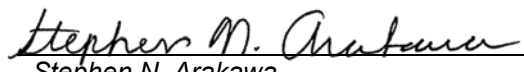
Policy

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

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

Fiscal Impact

Staff is currently assessing the impact of the SWP charges on the FY 2008/09 budget and future revenue requirements. Under terms of the water supply contracts, Metropolitan may file a protest of the charges in December.



Stephen N. Arakawa
Manager, Water Resource Management

10/8/2008
Date



Jeffrey Kightlinger
General Manager

10/8/2008
Date

Attachment 1 – Comparison of Metropolitan’s Statement of Charges for CY 2008 and CY 2009

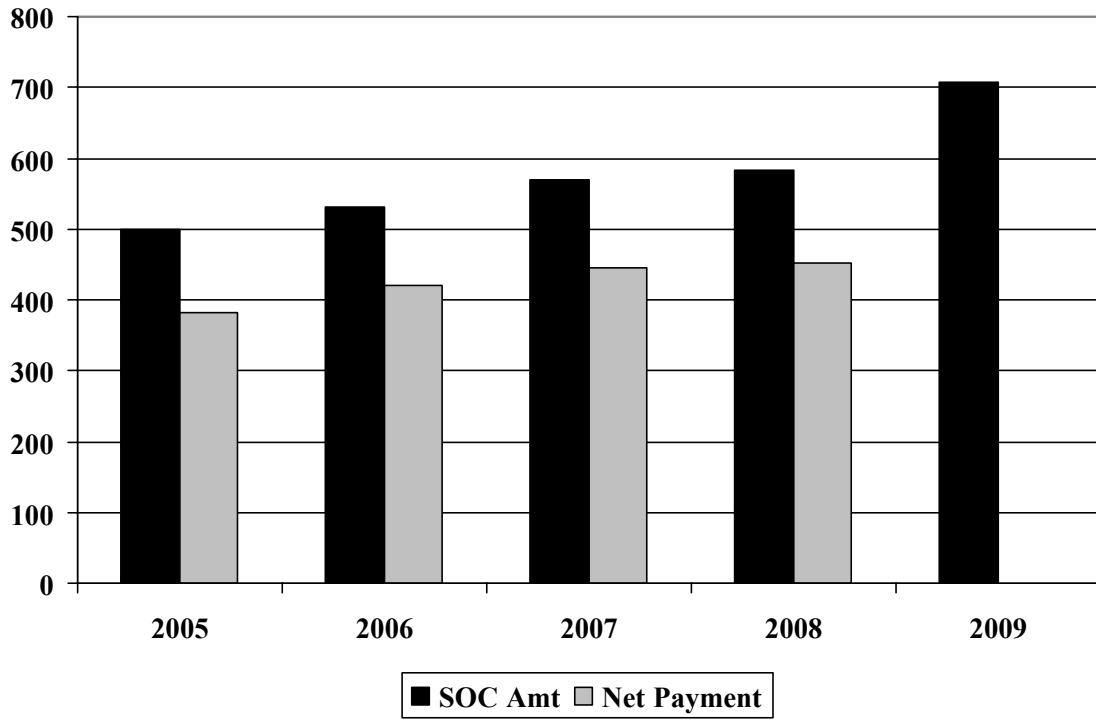
Attachment 2 – Comparison of SOC’s to Net Payments for the Last Four Years

Attachment 3 – Description of CY 2009 SOC Increases

Comparison of Metropolitan's Statement of Charges for CY 2008 and CY 2009 (\$ millions)			
	CY 2008 SOC	CY 2009 SOC	Change*
Total Power	\$ 278	\$ 330	52
Total Min OMP&R	161	209	49
Total Capital	145	169	23
Total SWP Charges	\$ 584	\$ 708	124

* Increase

Comparison of SOC's to Net Payments for the Last Four Years
\$ Millions



Description of CY 2009 SOC Increases

\$60 million increase in energy and transmission charges

- The drought has resulted in a reduction in energy generated at Hyatt. Hyatt is the key source of energy to pump project water. Reduced Hyatt energy must be substituted with higher priced purchased energy.
- The cost of purchased energy increased 13 percent from last year.
- Certain transmission charges are based on a revised transmission tariff that PG&E has requested be approved by FERC. The revised tariff would add \$16 million to the current transmission charge. Metropolitan, DWR, and others are seeking to settle with PG&E reducing the amount of the increase. Once a settlement is reached, the charges are expected to be reduced about \$5 million.
- Charges also increased \$11 million based on projected decreases in deliveries to Metropolitan's Central Valley storage programs and corresponding increase in deliveries into our service area.
- In the upcoming year, if SWP supply allocations, energy market rates, or variable transmission costs are less than projected, actual energy costs invoiced to Metropolitan will be lower.

\$27 million increase in charges to help reach a Delta Solution

- State Water Project contractors and Central Valley Project (CVP) Contractors are expected to enter agreements for the Delta Habitat Conservation and Conveyance Program (DHCCP) to fund planning, design, and environmental work in support of an approved conveyance system as part of a Delta solution. In anticipation of these agreements, DWR has temporarily incorporated the full amount of the 2009 program costs into the SOC, with Metropolitan's share totaling \$23 million.
- Metropolitan, DWR, and SWP contractors are preparing an agreement for funding the SWP contractor's share of the DHCCP EIR costs. Metropolitan, DWR, other SWP contractors and some Central Valley Project contractors are also working to ensure that a parallel funding agreement is negotiated between DWR and the Bureau of Reclamation which will cover the CVP contractor's share of the costs.
- The SOC will be reduced about \$7 million, representing Central Valley Project contractors' appropriate share of charges.
- DWR also increased the charges \$4 million annually in anticipation of additional costs associated with a renewed Delta Pumps Agreement. The Delta Pumps Agreement regulates Banks pumping plant operations. The increased charges will fund mitigation activities to offset the effect of future pumping on Delta fisheries. The Delta Pumps charges would be incurred once the agreement is signed.

\$19 million increase in infrastructure charges

- DWR has recently issued a substantial amount of new debt for its capital programs.
- Metropolitan's capital charge increase for infrastructure improvements is associated with a number of projects, including the Hyatt Turbine Refurbishment, Tehachapi East Afterbay, Control Technology Improvements, Communications Systems Upgrade, and the SWP share of the Reid Gardner No 4 power plant improvements.

\$6 million increase in Operations and Maintenance Charges

- DWR is projecting increases in Operations and Maintenance costs in the Delta to reflect a general increase in activity associated with current studies and fishery mitigation. Charges also increased to include costs to evaluate a replacement for the Reid Gardner power plant.

\$12 million increase due to adjustments in prior years Operation and Maintenance payments

- Each year's payments include an adjustment for differences between prior year's estimated and actual and projected costs for facility operations, maintenance, power, and replacement. As part of the audit our auditors are reviewing the accuracy and reasons for these adjustments. Auditor adjustments are expected to reduce charges \$5 million.
- The major increase this year is due to power costs associated with evaporative losses and reservoir storage level changes.