



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

November 10, 2009 Board Meeting

8-1

Subject

Consider and adopt changes to Cost-of-Service allocation methodology

Description

SUMMARY

In April 2009, the Board directed staff to work with member agencies and review Metropolitan's Cost-of-Service methodology for the 2010/11 rate cycle, evaluating the need for any changes and adjustments to rates and charges to reflect full Cost-of-Service. A workshop was held with the Board to discuss Cost-of-Service issues on September 22, 2009, and an information board letter was presented to the Business and Finance Committee in October describing changes that could be made to the Cost-of-Service methodology for the FY 2010/11 rate setting process.

This letter recommends a change to the existing Cost-of-Service methodology with regard to the costs associated with Metropolitan's use of Castaic Lake and Lake Perris for "flexible storage" of State Water Project (SWP) supplies. Staff recommends that costs associated with flexible storage be allocated to the Supply component. Under the Monterey Agreement, Metropolitan has the right to borrow flexible storage water from these reservoirs in addition to Table A receipts within the year, subject to refill within five years. This water provides a dry-year yield to Metropolitan and, consistent with how Metropolitan allocates the cost of its reservoirs, that portion of the respective reservoirs' costs would be functionalized as a supply-related cost, rather than as a conveyance-related cost. As a result, the System Access Rate would be reduced and the Supply Rate would increase.

Other rate structure issues, including a potential charge to recover treatment plant capacity-related costs separately from volumetric costs, options for changing Metropolitan's maximum *ad valorem* tax rate, treatment of SWP cost allocations and changes to or renewal of the Purchase Order Commitment will continue to be discussed, but changes to these factors are not recommended for the FY 2010/11 rate setting process. These issues will be addressed as the Board considers Metropolitan's strategic direction as identified through the Board's consideration of the Integrated Resources Plan (IRP) Update and Strategic Policy Review discussions.

DISCUSSION

Since June 2009, Metropolitan staff met with the Long Range Finance Plan (LRFP) workgroup to review the Cost-of-Service process and methodology. These discussions were summarized in a workshop held with the Board to discuss Cost-of-Service issues on September 22, 2009. An information board letter was presented to the Business and Finance Committee in October presenting changes that could be made to the Cost-of-Service methodology for the FY 2010/11 rate setting process. Based on the October board discussion and member agency comments, staff is recommending one change to the Cost-of-Service methodology for the FY 2010/11 rate setting process.

SWP Flexible Storage Cost Allocation

The LRFP workgroup reviewed the impact of assigning a portion of the costs for Castaic Lake and Lake Perris associated with flexible storage to the supply function. Under the Monterey Agreement, Metropolitan has the right to use water from these SWP reservoirs in addition to Table A receipts within the year, subject to refill

within five years. This water provides a dry-year yield to Metropolitan, and that portion of respective reservoirs' costs would be assigned to the Supply function, consistent with the treatment of Metropolitan's reservoirs. Using estimates of the cost of the SWP terminal reservoirs developed by Metropolitan's staff, this change would have resulted in an increase to the Supply function of about \$10 million, or about \$6 per acre-foot (AF) in the Tier 1 Supply Rate, and a decrease to conveyance of the same amount, or about \$5 per AF to the System Access Rate. These rate impacts are based on rates that fully recover the FY 2009/10 cost of service. Total SWP costs in the FY 2009/10 Revenue Requirement were \$479 million; the fully recovered Revenue Requirement for FY 2009/10 was \$1.38 billion. The estimated impact of this proposed change on each member agency had rates fully recovered the Cost-to-Serve in FY 2009/10 is shown in Table 1 below. The actual impact on each member agency will depend on actual deliveries of water during a given year, as well as the actual cost of the terminal reservoirs.

Table 1: Member Agency Impacts, SWP "Flexible" Storage Change, \$ in Millions

	Full COS	SWP Drought Storage to Supply	Change
Anaheim	\$ 15.6	\$ 15.6	\$ (0.0)
Beverly Hills	\$ 7.9	\$ 7.9	\$ (0.0)
Burbank	\$ 8.4	\$ 8.4	\$ (0.0)
Calleguas	\$ 73.1	\$ 73.1	\$ (0.0)
Central Basin	\$ 30.1	\$ 30.1	\$ (0.0)
Compton	\$ 2.0	\$ 2.0	\$ (0.0)
Eastern	\$ 70.8	\$ 70.8	\$ (0.0)
Foothill	\$ 7.9	\$ 7.9	\$ (0.0)
Fullerton	\$ 7.2	\$ 7.2	\$ (0.0)
Glendale	\$ 14.4	\$ 14.4	\$ (0.0)
Inland Empire	\$ 49.3	\$ 49.3	\$ 0.0
Las Virgenes	\$ 14.9	\$ 14.9	\$ (0.0)
Long Beach	\$ 24.8	\$ 24.8	\$ (0.0)
Los Angeles	\$ 269.5	\$ 269.6	\$ 0.1
MWDOC	\$ 153.5	\$ 153.4	\$ (0.0)
Pasadena	\$ 15.1	\$ 15.1	\$ (0.0)
San Diego	\$ 356.6	\$ 356.0	\$ (0.6)
San Fernando	\$ 0.2	\$ 0.2	\$ 0.0
San Marino	\$ 0.9	\$ 0.9	\$ 0.0
Santa Ana	\$ 9.4	\$ 9.4	\$ (0.0)
Santa Monica	\$ 8.8	\$ 8.8	\$ (0.0)
Three Valleys	\$ 46.5	\$ 46.4	\$ (0.0)
Torrance	\$ 14.2	\$ 14.2	\$ (0.0)
Up. San Gabriel	\$ 8.6	\$ 8.6	\$ (0.0)
West Basin	\$ 93.9	\$ 93.8	\$ (0.0)
Western	\$ 72.2	\$ 72.2	\$ 0.0
MWD Average	\$ 1,376.0	\$ 1,375.3	\$ (0.7)

Note: Rates are rounded to whole dollar amounts.

Implementing this change for FY 2010/11 would necessitate an estimate by staff, and as shown in Table 1, would have manageable impacts on the member agencies.

Longer Term Rate and Cost-of-Service Issues

The other rate structure issues will require additional discussion and debate with the member agencies and the Business and Finance Committee. These issues include collecting additional revenues through Metropolitan's *ad valorem* tax rate, any changes in the allocation of SWP costs, adding a treated water capacity charge to address peaking on the treated water system, and developing additional fixed revenues (e.g., changes in the Readiness-to-Serve charge or Standby charges) to meet Metropolitan's future debt service and contractual commitments. These changes, if any, could be implemented as part of the consideration and renewal of the purchase order agreements in 2012, and would benefit by the discussion resulting from the Board's consideration of the IRP and Strategic Policy Review. These latter two processes are expected to be completed by spring 2010, which will provide sufficient time to incorporate the results in the Cost-of-Service analysis and rates to be in place by FY 2012/13.

Policy

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

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

California Environmental Quality Act (CEQA)

CEQA determination for Options #1 and #3:

The proposed action is not defined as a project under CEQA because it involves continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed action is not subject to CEQA because it involves other government fiscal activities, which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment (Section 15378(b)(4) of the State CEQA Guidelines).

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

CEQA determination for Option #2:

None required

Board Options

Option #1

Adopt the CEQA determination and

- a. Direct staff to make a change to the Cost-of-Service methodology to assign a portion of SWP costs associated with flexible storage to the Supply function; and
- b. Make this change effective for the FY 2010/11 rate setting process.

Fiscal Impact: This proposed change to the Cost-of-Service methodology is revenue neutral to Metropolitan, but will have different impacts to member agencies.

Option #2

Direct staff to make no changes to the Cost-of-Service methodology and to continue to work with the member agencies on the Cost-of-Service methodology through the IRP and the Long Range Finance Plan.

Fiscal Impact: None

Option #3

Adopt the CEQA determination and direct staff to make changes to Cost-of-Service methodology to reflect other changes.

Fiscal Impact: The impact will be revenue neutral to Metropolitan, although differential impacts on member agencies may be significant.

Staff Recommendation

Option #1



Brian G. Thomas
Chief Financial Officer

10/21/2009
Date



Jeffrey Knightlinger
General Manager

10/23/2009
Date

BLA #6899