



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

9/14/2010 Board Meeting

9-2

**Subject**

Preliminary analysis of the State Water Project calendar year 2011 charges

**Description**

The Department of Water Resources (DWR), as required contractually, has provided Metropolitan the initial notice of calendar year (CY) 2011 charges for the State Water Project (SWP). DWR's recent practice has been to provide this initial notice and then revise and resubmit the charges in December to account for updated information. Staff plans to return to the Board in December to obtain authority to make payments for SWP charges in CY 2011, based upon the best available information at that time. Metropolitan's annual SWP cost is typically less than DWR's statement of charges (SOC) for two reasons:

1. DWR prepares the SOC based on optimistic water delivery assumptions; and
2. DWR does not include expected credits and other adjustments in the SOC.

Metropolitan's CY 2011 SOC, as determined by DWR, are \$607 million. As shown in [Attachment 1](#), this is a decrease of \$11 million below the CY 2010 SOC. The State Water Contract states that DWR may only charge for the actual cost for water deliveries. As such, the SOC includes estimates of next year's costs and adjustments for differences between previous years' estimated costs and the actual costs that were incurred. DWR's estimated CY 2011 SOC includes fixed charges, which do not vary based on water deliveries, and an estimate of the variable energy charges for 2011 based on an expectation of high water supply and the corresponding energy costs of pumping that water. Invoices for variable energy charges will be issued by DWR in 2011, after water is delivered. The variable invoice will reflect the actual cost for energy consumed to deliver Metropolitan's water delivered that month. The fixed charges total \$392 million, as shown in [Attachment 2](#), and are for operations, maintenance, capital, and past adjustments. Metropolitan is contractually obligated to pay these charges regardless of the quantity of water delivered.

The largest and most difficult cost to forecast continues to be the cost of energy to pump water. DWR's \$215 million energy estimate is high because it assumes deliveries to Metropolitan of 1.71 million acre-feet (MAF) in 2011. That delivery amount is a projection of 1.68 MAF delivered to Metropolitan's service area and 0.03 MAF delivered to Metropolitan's Central Valley Storage programs. In comparison, deliveries in CY 2010 are projected to be 1.28 MAF. The SOC provides a measure of the energy costs that could be incurred by Metropolitan for water under favorable hydrological and operating conditions. The CY 2011 delivery estimate will be refined as more information regarding next year's snowpack and pumping conditions is available. Energy cost is primarily driven by the total amount of water moved and market energy rates, offset by generation revenue.

An example of the projected charge Metropolitan might expect under lower water supply conditions is shown in [Attachment 3](#). If, for example, Metropolitan water receipts are 1.2 MAF instead of 1.7 MAF; the variable energy charge would be about \$154 million. Combined with the fixed cost of \$392 million, the total annual charge would be \$546 million. If a different level of supply is available, the variable charges would change at the rate of about \$12.8 million for each 100,000 acre-feet delivered into Metropolitan's service area.

Historically, actual expenditures have been lower than the SOC due to reductions in required energy and other adjustments, including credits DWR does not include in their SOC estimate. For example, the 2010 SOC was

\$618 million while staff estimates final net CY 2010 charges will be closer to \$509 million after accounting for lower water deliveries and additional credits.

DWR's projected charges are under review by staff and Metropolitan's outside SWP auditors Richardson and Company. Staff identified areas of concern and initiated discussions with DWR about revisions. These include the additional charge for the recently approved Delta Habitat Conservation and Conveyance Program funding that is expected to increase charges by about \$23 million. Discussions are ongoing concerning charges for some Delta mitigation activities and costs associated with Perris Dam remediation. Staff has requested a revised SOC from DWR incorporating changes based on these discussions.

The CY 2011 charges are in three major categories as described below.

#### Changes in the CY 2011 Statement of Charges

Component	CY 2010	CY 2011	Change (\$ millions)	Percent Change
Total Capital	153	172	19	11%
Total Maintenance	200	163	(37)	(19%)
Total Energy	265	272	7	3%
Total	618	607	(11)	(2%)

Capital - \$19 million increase; the capital charge is for the cost of infrastructure. \$7 million dollars of the increase is for new infrastructure and scheduled debt service increases. Also, \$11 million dollars of the increase is due to Rate Management Credits received last year that are not expected to be available in 2011. Rate Management credits were negotiated as part of the Monterey Amendment and, when available, serve to reduce capital charges.

Maintenance - \$37 million decrease; the maintenance charge is for operations and maintenance costs of project conservation and conveyance facilities. Much of the decrease of \$37 million is due to adjustments for past overcharges and delays in signing an agreement for increased Delta Habitat Conservation and Conveyance Program funding.

Energy - \$7 million increase, reflects DWR's assumptions related to purchased energy prices, generation energy use and sales revenue, and expected water deliveries to Metropolitan. Overall, DWR anticipates stability in the unit cost of energy. However, DWR is showing a \$26-million increase resulting from increased deliveries to Metropolitan's service area. Offsetting the \$25-million increase is a \$19-million greater credit for past overcharges for energy.

#### Preliminary Analysis of CY 2011 Statement of Charges

Annually, Metropolitan undertakes an in-depth analysis and audit of the charges. Because the SOC is derived from estimates made for the upcoming year, Metropolitan expects DWR to revise specific invoices after reviewing comments from Metropolitan and other contractors. Furthermore, because DWR issues invoices based on its estimates, additional corrections and adjustments will occur in subsequent years after actual costs are determined.

#### Future Steps

Staff continues to work with the other contractors and DWR to analyze SWP costs and savings strategies. 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. In December, staff expects to present the results of the independent audit, and request the Board to authorize payment of the CY 2011 invoices up to a recommended amount based on an expected water delivery scenario.

## Policy

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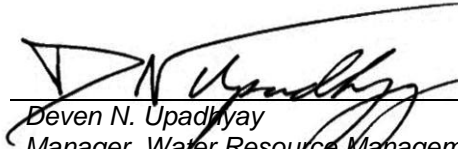

Each year, the Board considers authorizing the General Manager to make payments for the CY charges under Metropolitan's SWP contracts.

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

## Fiscal Impact

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Staff is currently assessing DWR's initial projected CY 2011 SWP charges of \$607 million on Metropolitan's fiscal year 2010/11 budget and future revenue requirements. Historically, Metropolitan's actual CY payments are less than DWR's Statement of Charges.

 Deven N. Upadhyay Manager, Water Resource Management	9/7/2010 Date
 Jeffrey Kightlinger General Manager	9/8/2010 Date

**Attachment 1 – Comparison of Metropolitan's Statement of Charges for CY 2010 and 2011**

**Attachment 2 – Schedule of Fixed CY 2011 Charges**

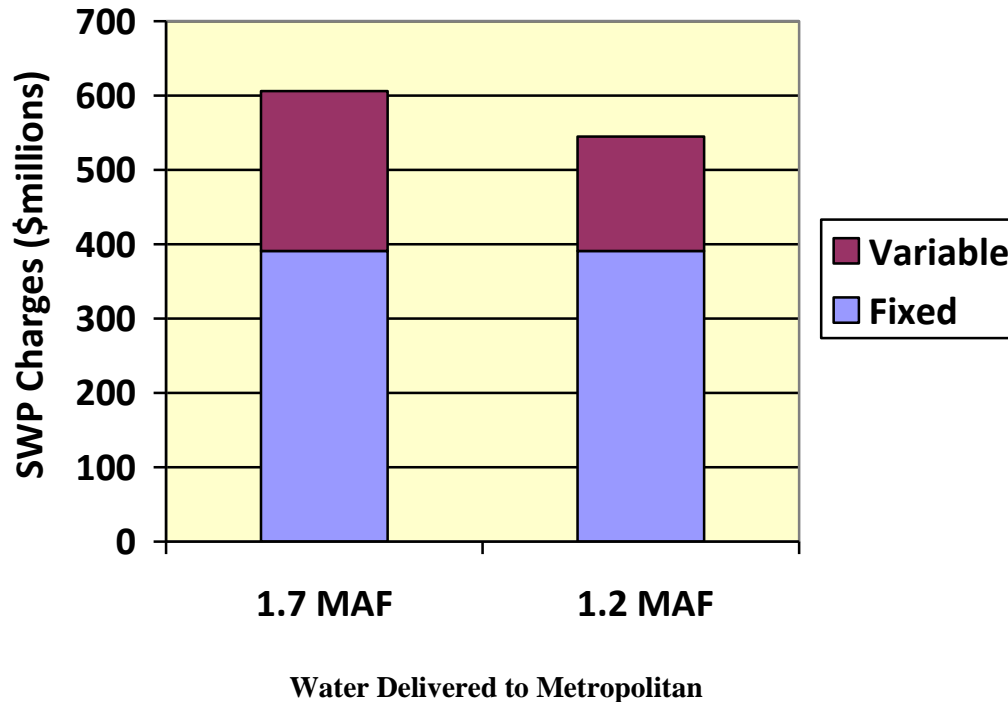
**Attachment 3 – Comparison of Charges under Lower Supply Conditions**

Ref# wrm12606557

<b>Comparison of Metropolitan's Statement of Charges for CY 2010 and CY 2011</b>			
(\$ millions)			
	<b>CY 2010 SOC</b>	<b>CY 2011 SOC</b>	<b>Change</b>
Off Aqueduct	\$ 84	\$ 100	16
Past Energy Adj	(24)	(43)	(19)
Variable	205	215	10
<b>Total Power</b>	<b>265</b>	<b>272</b>	<b>7</b>
<b>Total Operating</b>	<b>200</b>	<b>163</b>	<b>(37)</b>
<b>Total Capital</b>	<b>153</b>	<b>172</b>	<b>19</b>
<b>Total SWP Charges</b>	<b>\$ 618</b>	<b>\$ 607</b>	<b>(11)</b>

**Schedule of CY 2011 Fixed Charges**

<b>Component Charge</b>	<b>CY 2011 SOC (\$ millions)</b>
Off Aqueduct Power Facilities	100
Past Years Energy Adjustment	(43)
Total Operations & Maintenance	163
Total Capital	<u>172</u>
<b>Total Fixed SWP Charges</b>	392

**Figure 1 - Comparison of Charges under Lower Supply Conditions**

The fixed or core charges for 2011 total \$392 million and are shown in Attachment 2. These include the charges for capital, operations and maintenance, adjustment for prior years overcharges of variable, and the fixed energy charges. The variable component is based on DWR's estimate of delivering 1.7 MAF to Metropolitan and higher prices for purchased energy. DWR's estimate of the variable energy charge for delivery of 1.7 MAF is \$215 million. Combined, these charges are a total of \$607 million. It is likely that in 2011, Metropolitan's water receipts will be substantially less than 1.7 MAF due to environmental restrictions and drought.

If Metropolitan water receipts are 1.2 MAF, similar to this year instead of 1.7 MAF, then the variable charge to deliver 1.2 MAF would be about \$154 million. Combined with the fixed cost of \$392 million, the total would be \$546 million. If a different level of supply is available, the variable charges would change at the rate of about \$12.8 million for each 100,000 acre-feet delivered into Metropolitan's service area.