



- Board of Directors  
*Legal and Claims Committee*

6/14/2011 Board Meeting

8-7

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## Subject

Review Rate Structure Integrity provisions of conservation and Local Resources Program funding agreements with San Diego County Water Authority; and consider termination of agreements

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## Description

### Background

At its August 17, 2010 meeting, the Board of Directors authorized the General Manager to initiate the process to terminate six local resources and conservation agreements with the San Diego County Water Authority (Water Authority) that include rate structure integrity (RSI) provisions, and to defer execution of three pending agreements.

Since that time, Metropolitan and the Water Authority engaged in mediation as set forth in the dispute resolution terms of the RSI provisions. Formal mediation between Metropolitan and the Water Authority took place on March 9, 2011 for four bilateral agreements and was scheduled for June 6, 2011 for an agreement involving a third party. One agreement has since been paid in full and has terminated by its own terms. The RSI provisions state that if mediation does not result in a mutually acceptable agreement, the matter goes to the Board of Directors for final determination on whether to terminate the agreements.

### Rate Structure Integrity provisions

Adopted by the Board in 2004, the RSI provisions define a process through which Metropolitan can terminate conservation or other local resources incentive agreements with a member agency that chooses to pursue legal or legislative challenges to Metropolitan's existing rate structure outside of established public board processes. The objective of this language is to protect revenue sources necessary to fund Metropolitan's water management incentive programs. Subsequent to board adoption in 2004, standardized RSI terms have been included in all local resources, seawater desalination, and conservation program incentive agreements. The full text of the RSI language, including notice and dispute resolution procedures, is included in [Attachment 1](#). The agreements subject to this action are listed in [Attachment 2](#).

### Legal Challenge by Water Authority

In June 2010, the Water Authority initiated litigation challenging Metropolitan's water rates and charges adopted April 13, 2010. This act triggered the termination and dispute resolution provisions of the RSI provisions in several existing incentives agreements with the Water Authority.

### Notice and Dispute Resolution Proceedings

As set forth in the RSI provisions and after consultation with the Board of Directors, the General Manager sent the Water Authority the required 90-day notices of possible termination for four bilateral agreements, effective August 30, 2010. On September 27, 2010, the Water Authority requested mediation. Metropolitan and the Water Authority met in mediation on March 9, 2011, before retired Justice Howard B. Wiener.

Although both sides made good-faith efforts to find a mutually acceptable solution, no agreement resulted. After the mediation, the Chairman of the Water Authority Board wrote the Chairman of Metropolitan's Board

requesting a continuation of the mediation on a board to board basis. By a letter to Chairman Hogan dated April 14, 2011, Chairman Foley declined the request and effectively concluded the mediation. Metropolitan provided a separate notice of potential termination concerning two agreements involving the Water Authority's retail agencies.

On October 19, 2010, Metropolitan issued a 90-day notice of intent to terminate two agreements with the Water Authority that included Ramona Municipal Water District (Ramona) as a party and Rincon del Diablo Municipal Water District (Rincon) as funding recipient and notified all parties of their ability to request mediation. Neither Ramona nor Rincon responded to the notice or requested mediation. The Water Authority requested mediation on November 17, 2010. In January 2011, the Rincon agreement was fully paid and expired by its own terms. The Water Authority declined Metropolitan's request to include the three-party agreement in the March 9 mediation and took no further steps to pursue it. Staff concluded that the Water Authority had waived its mediation rights.

On May 9, 2011, Metropolitan received written notice from the Water Authority that, in their view, the Water Authority had not waived mediation of the Ramona agreement. As a result of that communication, Metropolitan and the Water Authority scheduled a second mediation for June 6, 2011, also before Justice Wiener and including a representative from Ramona, specifically on the Ramona contract for the San Vicente Water Recycling Project.

### **Board Action**

At its May 10, 2011 meeting, the Legal and Claims Committee considered termination of all remaining agreements. The Committee adopted a resolution approving termination of the open agreements with the Water Authority but maintaining programs that provide direct rebates to consumers through Metropolitan's regional incentives programs. Policy discussion among board members focused on Metropolitan's historic, long-standing support for conservation. The Committee also discussed the ramifications of the new statewide conservation target of a 20 percent reduction in per capita water use by 2020 that was included in legislation sponsored by Metropolitan. The Committee also instructed staff to defer execution of any pending agreements with the Water Authority prior to further direction from the Board. At the board meeting of May 10, 2011, the Board acted to table consideration of the termination of these contracts until its June 14, 2011 meeting, to allow for further discussion of the modified action.

### **Pending Agreements**

The three pending agreements with the Water Authority that would be subject to the Board's direction to defer execution are described below.

On November 10, 2009, the Board authorized entering into a Seawater Desalination Program agreement with the Water Authority and its retail agencies for the Carlsbad Seawater Desalination Project. The authorized agreement includes several sub-agencies of the Water Authority as parties and includes the standard RSI provisions. On July 22, 2010, the Water Authority's board of directors authorized a draft term sheet and directed its staff to prepare a water purchase agreement with Poseidon Resources LLC for direct purchase of product water from the Carlsbad Seawater Desalination Project. If such an agreement is completed, the material terms would be different from the proposed agreement authorized by Metropolitan's Board for the project. In that case, Metropolitan staff will bring the new agreement regarding the Carlsbad Seawater Desalination Project back to the Board for consideration.

The pending Agricultural Conservation Program agreement would provide incentives for professional irrigation audits and installation of water conservation improvements. The pending agreement in the Innovative Conservation Program would fund new research on flow control valves.

### **Options**

Staff has developed four options for board consideration:

**Option #1:** Under this option, the Board would approve termination of all contracts with Water Authority containing RSI language. This option is consistent with the RSI language that was adopted by the Board and implemented in these contracts.

**Option #2:** This option is the same as Option #1, but Metropolitan would establish an interest-bearing fund to hold payments that would have been paid under the terminated agreements, to the extent that such amounts can reasonably be calculated and the information for such calculations is provided to Metropolitan by the Water Authority. Upon completion of the pending litigation over Metropolitan's existing rate structure, the Board will determine at its sole discretion whether and on what terms to provide any portion of these funds to the Water Authority.

**Option #3:** Under this option, the Board would approve termination of all contracts with Water Authority containing RSI language, except for the regional commercial and residential conservation incentive agreements providing payments directly to consumers. Maintaining the conservation agreements would allow residents within the Water Authority service area to continue to receive rebates from Metropolitan's regional programs when they purchase eligible conserving devices. This option reflects the Committee's recommended action of May 10 that was later tabled at the May board meeting.

**Option #4:** Under this option, no agreements would be terminated. The Board would also instruct staff to execute pending incentive agreements with the Water Authority, as appropriate.

### **Recommendation**

Staff recommends Option #1, to terminate the existing incentive agreements with the Water Authority that contain rate structure integrity language. This option is consistent with the policy set forth by the RSI language. Staff will also continue to defer the approval of any pending agreements with the Water Authority requiring inclusion of the RSI provisions, until authorized by the Board.

### **Policy**

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By Minute Item 46045, dated December 14, 2004, effective April 15, 2005, the Board authorized inclusion of rate structure integrity language in all future local resources, seawater desalination, and conservation program incentive agreements.

By Minute Item 48266, dated May 11, 2010, the Board approved the water conservation plan for FY 2010/11 that includes the Agricultural Conservation Program.

By Minute Item 44974, dated August 20, 2002, the Board authorized the Innovative Conservation Program on a biennial basis.

By Minute Item 48084, dated November 10, 2009, the Board authorized entering into a Seawater Desalination Program agreement with the San Diego County Water Authority and its retail agencies for the Carlsbad Seawater Desalination Project.

By Minute Item 48377, dated August 17, 2010, the Board expressed support for the General Manager to initiate the process to terminate six local resources and conservation agreements with the San Diego County Water Authority that include rate structure integrity provisions and to defer execution of pending conservation and LRP agreements with the Water Authority.

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

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

During preliminary environmental review, the lead agency must first determine whether an activity proposed by a public agency is subject to CEQA before preparing and conducting an initial study and environmental checklist. Given the contractual nature of the activity presented in the board letter, the proposed action is not defined as a project under CEQA or the State CEQA Guidelines and is therefore not subject to the provisions of CEQA pursuant to Sections 15060(c)(3), 15061(b)(3), 15378(b)(2), 15378(b)(4), and 15378(b)(5) of the State CEQA Guidelines. The proposed action simply terminates existing agreements for projects whose potential effects were previously addressed in other adopted/certified CEQA documents. Accordingly, no further environmental review is required.

The CEQA determination is: Determine that the proposed action is not subject to the provisions of CEQA pursuant to Sections 15060(c)(3), 15061(b)(3), 15378(b)(2), 15378(b)(4), and 15378(b)(5) of the State CEQA Guidelines.

CEQA determination for Option #4:

None required

## Board Options

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### Option #1

Adopt the CEQA determination and approve termination of five conservation and Local Resources Program funding agreements with San Diego County Water Authority pursuant to the rate structure integrity provisions of those agreements.

**Fiscal Impact:** Cost savings realized from terminated incentive payments would be factored into Metropolitan's rate projections and future budgets. Financial exposure to local resources and conservation program incentives would be diminished.

**Business Analysis:** Staff would also review potential reallocation of budgeted FY 2010/11 and FY 2011/12 conservation funds and other incentive-related administrative actions.

### Option #2

Adopt the CEQA determination and

- a. Approve termination of five conservation and Local Resources Program funding agreements with San Diego County Water Authority pursuant to the rate structure integrity provisions of those agreements; and
- b. Direct the General Manager to establish a separate interest-bearing fund to hold payments that would be paid under such agreements to the extent that such amounts can reasonably be calculated and the information for such calculations is provided to Metropolitan by the Water Authority. Upon completion of the pending litigation over Metropolitan's existing rate structure, the Board will determine at its sole discretion whether and on what terms to provide any portion of these funds to the Water Authority.

**Fiscal Impact:** None. Incentive payments factored into Metropolitan's rate projections and future budgets would remain unchanged.

**Business Analysis:** Staff would need to make judgments on estimated payments and amount to place into separate account.

### Option #3

Adopt the CEQA determination and

- a. In order to continue providing Metropolitan's regional residential and commercial direct rebates to citizens within the Water Authority's service area, do not approve termination of the two regional commercial and residential conservation incentives agreements. Instead, direct staff to cease approving or providing funding for Water Authority's member agency administered conservation projects through the regional agreements.
- b. Approve termination of the remaining three conservation and Local Resources Program funding agreements with San Diego County Water Authority pursuant to the rate structure integrity provisions of those agreements.

**Fiscal Impact:** Cost savings realized from terminated incentive payments would be factored into Metropolitan's rate projections and future budgets. Financial exposure to local resources and conservation program incentives would be diminished.

**Business Analysis:** Staff would continue to administer the existing regional commercial and residential conservation incentives agreements for residents within the Water Authority service area. Staff would also review potential reallocation of budgeted FY 2010/11 and FY 2011/12 conservation funds and other incentive-related administrative actions.

**Option #4**

- a. Do not approve termination of existing conservation and Local Resources Program funding agreements with San Diego County Water Authority pursuant to the rate structure integrity provisions of those agreements; and
- b. Direct the General Manager to proceed as appropriate with execution of pending incentive agreements with San Diego County Water Authority.


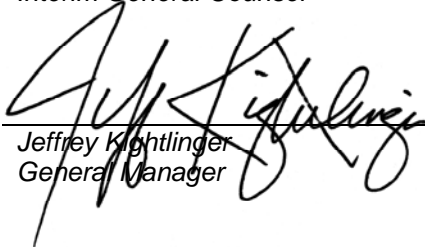
**Fiscal Impact:** None. Incentive payments factored into Metropolitan’s rate projections and future budgets would remain unchanged.

**Business Analysis:** Staff would continue to administer existing agreements.

**Staff Recommendation**

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Option #1

	6/2/2011
_____ Marcia L. Scully Interim General Counsel	Date
	6/2/2011
_____ Jeffrey Kightlinger General Manager	Date

**Attachment 1 – Rate Structure Integrity Provisions adopted by Metropolitan on December 14, 2004**

**Attachment 2 – San Diego County Water Authority Incentive Agreements**

**Rate Structure Integrity Provisions**  
**adopted by Metropolitan's Board of Directors on December 14, 2004**

1. **[Recipient]** and **[Member Agency]** if different than **Recipient** agree and understand that Metropolitan's rate structure as of January 1, 2004 ("Existing Rate Structure") provides the revenue necessary to support the development of new water supplies by local agencies through incentive payments in the Local Resources Program (LRP), Conservation Credits Program (CCP), and the Seawater Desalination Program (SDP). In particular, the Water Stewardship Rate is the component of Existing Rate Structure that provides revenue for the LRP, CCP and SDP. Further, **[Recipient]** and **[Member Agency]** acknowledge that Existing Rate Structure and all components within that rate structure were developed with extensive public input and member agency participation, and that the elements of Existing Rate Structure have been properly adopted in accordance with Metropolitan's rules and regulations.
2. (a) **[Recipient]** and **[Member Agency]** agree that Metropolitan's rates set under the Existing Rate Structure may be reset throughout the term of this Agreement to account for the cost of service, and that **[Recipient]** and **[Member Agency]** will address any and all future issues, concerns and disputes relating to Existing Rate Structure, through administrative opportunities available to them pursuant to Metropolitan's public board process. As such, **[Recipient]** and **[Member Agency]** agree if they file or participate in litigation or support legislation to challenge or modify Existing Rate Structure, including changes in overall rates and charges that are consistent with the current cost-of-service methodology, Metropolitan may initiate termination of this agreement consistent with Paragraph 4 below. Metropolitan agrees that any change in Existing Rate Structure, including changes in cost-of-service philosophy or methodology would be enacted only after collaboration and discussion with its member public agencies, and Metropolitan's public board review and approval process.  
(b) Notwithstanding the foregoing, **[Recipient]** and **[Member Agency]** retain the right to file and/or participate in litigation and/or to support legislation without triggering the termination of this agreement if there are material changes to Existing Rate Structure or changes in cost-of-service methodology used to set rates by future Metropolitan board action. **[Recipient]** and **[Member Agency]** also retain the right to file and/or support litigation should Metropolitan, in setting rates under Existing Rate Structure, fail to comply with public notice, open meeting, or other legal requirements associated with the process of setting water rates and related taxes, fees, and charges. **[Recipient]** and **[Member Agency]** agree that they will not file or participate in litigation, nor will they support legislation affecting Metropolitan's rate structure after any such change in rate structure or violation of the law regarding rate setting processes until, and unless, they have exhausted all administrative opportunities available to them pursuant to Metropolitan's public board process.
3. **[Recipient]** and **[Member Agency]** agree that all users of the Metropolitan conveyance and distribution system should support the LRP, CCP, and SDP, that such projects provide benefits to Metropolitan and the users of the system by making existing distribution and conveyance capacity available for additional delivery, and that under Existing Rate Structure, the Water Stewardship Rate is an element of charges properly adopted by the Metropolitan Board and properly applied to water wheeled through the Metropolitan conveyance and distribution system.

4. Should **[Recipient]** or **[Member Agency]** file or support litigation, or sponsor or support legislation, that would challenge or be adverse to Existing Rate Structure, as described in Paragraph (a) of Section 2, Metropolitan's Chief Executive Officer may file a 90-day notice of intent to terminate this Agreement with Metropolitan's Executive Secretary, with copies to all members of Metropolitan's Board of Directors, and contemporaneously provide **[Recipient]** and **[Member Agency]** with a copy of the notice. Within 30 days of receipt of such notice, **[Recipient]** and **[Member Agency]** shall have the right to request, in writing, mediation of the dispute by a neutral third party with expertise in finance and rate setting. The mediator shall be selected by agreement of the parties, or failing agreement within 60 days of such request for mediation, a mediator shall be selected by the Metropolitan Board of Directors from a list of at least four candidates, one each from **[Recipient]** and **[Member Agency]**, and two of which will be supplied by Metropolitan's Chief Executive Officer. The cost of the mediation shall be borne equally by the parties. The request for mediation shall also serve to stay the 90-day notice of intent to terminate, but for no more than 90 days beyond the filing of the notice of request for mediation, unless otherwise agreed in writing by the parties. If mediation does not result in an agreement acceptable to each party to this Agreement within the time provided herein, the notice of intent to terminate shall be reinstated. The Metropolitan Board of Directors shall act to approve or disapprove termination of this Agreement, and all of Metropolitan's obligations hereunder shall terminate if approved, on or before the ninetieth day following filing of the notice to terminate or, if mediation has been requested as described above, the ninetieth day following the request for mediation (or other date agreed in writing by the parties.)

5. Metropolitan and **[Recipient]** and **[Member Agency]** agree that should litigation or legislation brought forth or sponsored by third parties result in changes to Existing Rate Structure, this Agreement will continue in effect unless mutually agreed in writing by the parties.

6. Should Metropolitan and its member agencies agree on an alternative rate and revenue structure that obviates the need for this section on Rate Structure Integrity, this section shall be amended or deleted to conform to such action.

7. Notwithstanding the foregoing, Metropolitan shall have no power or authority under this Section to terminate this Agreement, and Metropolitan's Chief Executive Officer shall not file a 90-day notice of intent to terminate this Agreement, if a **[Member Agency]** (but not the **[Recipient]**) files or participates in any litigation or supporting legislation to challenge or modify Existing Rate Structure, but the **[Recipient]** transmits a writing to Metropolitan's Chief Executive Officer within thirty (30) days of request therefore from Metropolitan, stating that **[Recipient]** has not participated directly or indirectly in the filing or prosecution of any litigation or the drafting or advocacy of any legislation to challenge or modify Existing Rate Structure, and indicates support for Existing Rate Structure.

Note: **[Recipient]** refers to project owner.

### San Diego County Water Authority Incentive Agreements

Subject to termination:

Agreement	Target Yield	Max. Payable* (\$1,000)	Funded (4-30-2011) (\$1,000)	Balance (\$1,000)
1. Enhanced Conservation Program – Landscape water conservation training	2,362 AF	\$143	\$124	\$19
2. Enhanced Conservation Program – Conversion project to climate appropriate landscape	5,829 AF	\$1,125	\$535	\$590
3. Regional Commercial Program – Commercial incentives	TBD	N/A	\$6,500	N/A
4. Regional Residential Program – Residential incentives	TBD	N/A	\$9,000	N/A
5. Local Resources Program – Water Recycling and Groundwater Recovery incentives (Ramona)	340 AFY	\$1,280	\$21	N/A

Subject to deferral:

6. Carlsbad Seawater Desalination Project	56,000 AFY	\$350,000 (est.)	\$0	N/A
7. Agricultural Conservation Program – Agricultural incentives	N/A	N/A	\$0	N/A
8. Innovative Conservation Program – Flow control valve research project	N/A	\$11	\$0	N/A