



- Board of Directors
Finance and Insurance Committee

9/13/2011 Board Meeting

9-1

Subject

Preliminary analysis of the State Water Project calendar year 2012 charges

Description

The Department of Water Resources (DWR) has provided Metropolitan the initial notice of calendar year (CY) 2012 charges for the State Water Project (SWP) totaling \$557 million. DWR’s recent practice has been to provide an initial notice in mid-calendar year and then revise and resubmit the charges in December to account for updated information. Consistent with the Administrative Code provisions for State Water Contract payments, staff will return to the Board for authorization to pay the SWP charges. Staff plans to seek an authorization for payment of the identified fixed charges and a reasonable estimate of the variable charges. Actual payments in 2012 will be for the fixed charges plus the variable charges associated only with the actual amount of water received. This board letter addresses the initial charges that DWR has identified for CY 2012.

Methodology for Determining SWP Payment Authorization Amount

Historically, DWR’s initial estimate has been higher than Metropolitan’s actual payments (see Figure 1). The principal reason for the difference was a high assumption for deliveries into Metropolitan’s service area of 1.7 million acre-feet (MAF). Because this methodology usually overestimated variable charges, Metropolitan’s past practice has been to seek board authorization for SWP charges based on a lower projection of expected deliveries. Staff sought authorization based on projected deliveries of 1.1 MAF in 2009, 1.2 MAF in 2010, and 1.5 MAF in 2011. In each case, these projected deliveries were lower than the assumption of 1.7 MAF that DWR used to draft the Statement of Charges.

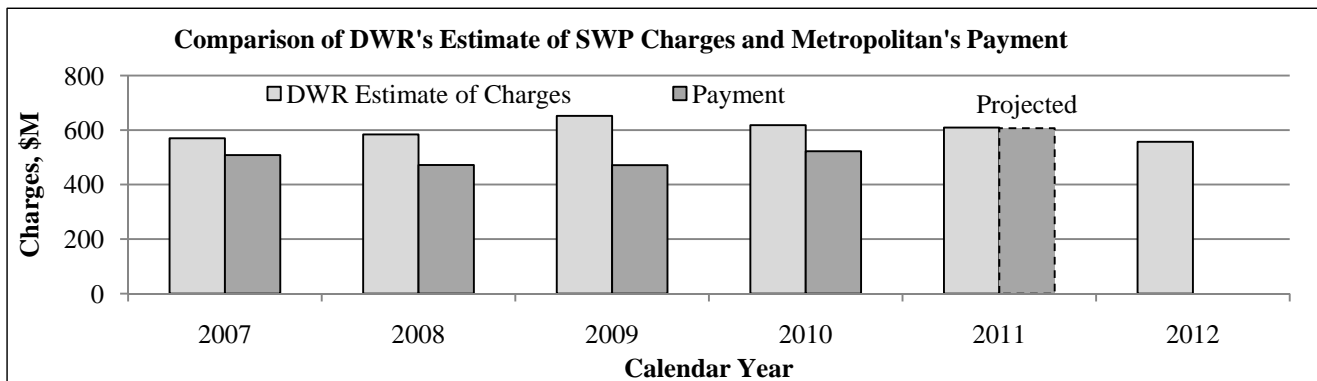


Figure 1

DWR has recently changed its methodology for estimating variable power charges. Previously, DWR based variable charges on the capacity of the system to deliver contracted Table A water. Now, DWR is assuming an average annual Table A deliveries of 60 percent as determined in the *State Water Project Delivery Reliability Report 2009*. This assumption is equivalent to 1.1 MAF of SWP deliveries into the service area. Unlike previous years, the new methodology could underestimate Metropolitan’s calendar year SWP energy payments to DWR in a year of above average hydrology.

Summary of Metropolitan's CY 2012 SWP Charges

Metropolitan's CY 2012 charges of \$557 million can be broken into two categories: (1) fixed charges for capital and core administration and maintenance activities, and (2) variable charges for the amount of energy consumed in pumping its water.

The fixed charges, totaling \$430 million (see Table 1), are for operations, maintenance, capital, and past adjustments. Metropolitan is contractually obligated to pay fixed charges regardless of the quantity of water delivered. In CY 2012 the fixed charges include additional charges related to compliance with the SWP biological opinions. The charges reflect a deferral of the reconstruction of Perris Reservoir.

DWR's initial estimates do not include potentially significant anticipated charges related to:

- Bay Delta Conservation Plan (BDCP) and Delta Habitat Conservation and Conveyance Program (DHCCP);
- Delta activities of the State and Federal Water Contractors Agency;
- Required measures under a new Oroville FERC license; nor
- Settlement agreement in the California Parties energy crisis litigation.

DWR will issue revised charges once the costs of the above activities become known.

Staff anticipates that Off Aqueduct Power Facilities (OAPF) charges will increase as DWR refines the delivery basis upon which energy charges are estimated. OAPF charges are apportioned to contractors based on their projected energy requirements to move water during the calendar year. DWR's initial estimate based Metropolitan's energy charges on projected service area deliveries of only 980 thousand acre-feet (TAF) and deliveries to San Joaquin Valley storage of 167 TAF. Significantly more energy is required to deliver water into the service area versus into San Joaquin Valley storage. Thus, Metropolitan's OAPF charges will increase as the ratio of service area deliveries to non-service area deliveries increases. The variable charges for moving 980 TAF into the service area and 167 TAF into San Joaquin Valley storage total \$127 million. Energy charges increase as deliveries into the service area increase. For example, deliveries of 1.5 MAF into the service area would result in increased variable charges of \$63 million.

Table 1 – Changes in SWP Charges between CY 2012 and CY 2011 (\$million)

Fixed Components	Initial CY 2012	Revised CY 2011	Change	Percent Change
Total Capital	167	158	9	6%
Total Operations & Maintenance	177	172	5	3%
Fixed Energy	86	64	22	34%
Off Aqueduct Power Facilities	98	107	(9)	(9%)
Prior Years Energy Adjustment	(12)	(43)	31	72%
Total Fixed Charges	430	394	36	9%
Variable Energy Component	127	215	(88)	(41%)
Total Charges	557	609	(52)	(9%)

Comparison of CY 2012 and CY 2011 Charges

DWR's estimate of Metropolitan's CY 2012 SWP charges is \$52 million less than Metropolitan's CY 2011 charges (see Table 1). The largest change is the charge for energy which reflects DWR's reduced delivery assumptions.

Total capital charges for CY 2012 are \$9 million greater than CY 2011, and total operations and maintenance charges are \$5 million greater than in CY 2011. The increase in operations charges is due to costs of complying with biological opinions. Most of the increase in capital costs is due to reduced rate management credits. Rate management credits were negotiated as part of the Monterey Amendment, and serve to reduce capital charges when available. DWR's initial estimates have reduced rate management credits in 2012, but these figures will be updated as DWR refines the numbers.

The overall reduction in CY 2012 charges is due to the change in delivery assumptions used to calculate the variable portion of the energy charges. The net decrease of \$66 million in energy charges between 2011 and 2012 is due to an \$88-million decrease in estimated variable charges and a \$9-million decrease in estimated OAPF charges. This is combined with a decrease of \$31 million in the credit received for an adjustment to prior years' energy charges (see Table 2). The large credit received in 2011 was a result of unanticipated revenue received in 2010 from sales through CallISO's new energy marketing program, and actual energy costs and energy purchases being lower than anticipated.

Component	Revised CY 2011	Initial CY 2012	Change	Percent Change
Off Aqueduct Power Facilities	107	98	(9)	(9%)
Prior Years Energy Adjustment	(43)	(12)	31	72%
Variable	215	127	(88)	(41%)
Total Energy Charges	279	213	(66)	(24%)

Future Steps

DWR's projected charges are under review by staff and Metropolitan's outside SWP auditors Richardson and Company. Staff has identified areas of concern and initiated discussions with DWR about revisions. These include revising the breakdown of deliveries to the service area versus out of basin storage. 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 2012 charges. The request for authorization will be for payment up to an amount which incorporates updated information from DWR, and a CY 2012 delivery estimate based on a review of budget and demand projections.

Policy

Metropolitan Water District Administrative Code Section 5112: State Water Contract Payments

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

Staff is currently assessing DWR's initial projected CY 2012 SWP charges of \$557 million on Metropolitan's fiscal year 2011/12 budget and future revenue requirements.



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8/25/2011
Date



Jeffrey Knightlinger
General Manager

8/30/2011
Date

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