



● **Review of current Replenishment Service Program and proposed policy principles**

Summary

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Metropolitan has been delivering discounted water to replenish local storage since the 1950's, through a variety of programs developed over the years, including the Interruptible Program, Seasonal Storage Service and the current Replenishment Service Program. The Replenishment Service Program incentivizes agencies to increase purchase and delivery of imported water into local storage during periods of favorable supply. Under the program Metropolitan has the ability to interrupt these deliveries when needed. Revisions to the Replenishment Service Program are being discussed with the goal of further enhancing regional reliability benefits associated with the program. Since March 2011, Metropolitan staff has engaged in a workgroup process with the member agencies and groundwater basin managers to discuss potential revisions to the program. This letter provides a brief overview of the current program along with potential policy principles that could guide the development of a revised program.

Overview of Current Replenishment Service Program

Under the existing Replenishment Service Program, imported water is delivered to an agency for storage in local groundwater basins or reservoirs. Replenishment Service water may be used to increase local storage, increase the operating yield of a groundwater basin above the safe yield operation, or refill a previous years' groundwater basin overdraft.

Replenishment Service is a "pay-for-performance" program for storage in the year being certified. The participating agency receives a discount on water purchased by the agency for replenishment purposes. However, this is an interruptible supply, meaning that Metropolitan can cease deliveries of Replenishment Service deliveries at its sole discretion, typically during periods of high demand, emergencies, or shortages. In turn, agencies are expected to offset such interruptions with local production from their groundwater basins or reservoirs.

Metropolitan's Administrative Code highlights the three principal goals of the current Replenishment Service Program:

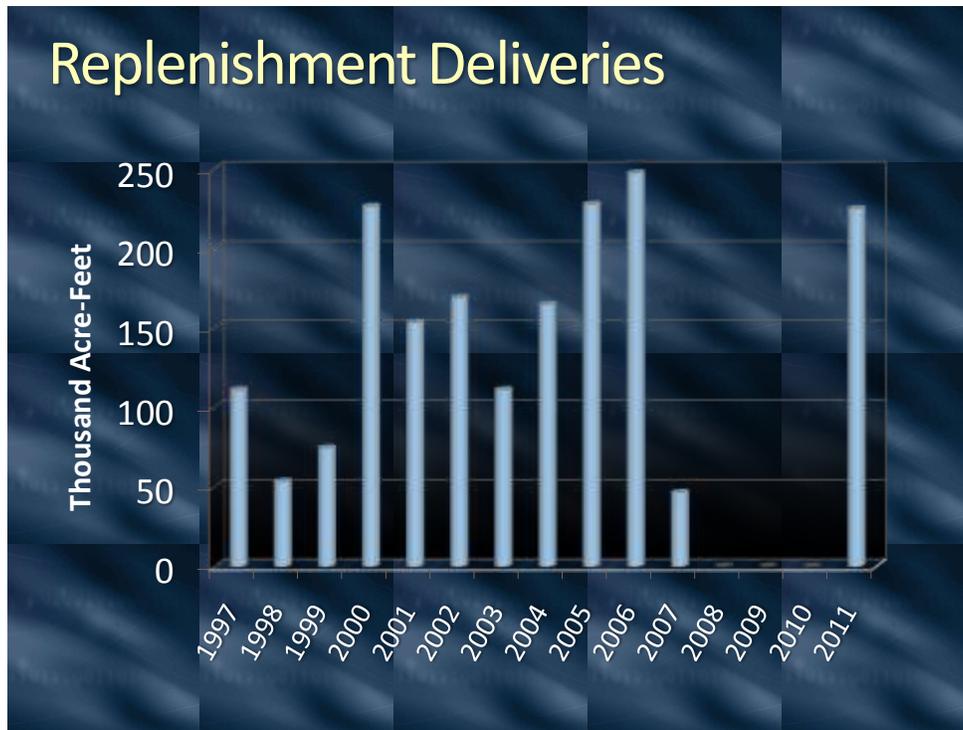
- Encourage storage of surplus imported water when supplies are available;
- Encourage construction of additional local production facilities; and,
- Reduce member agencies' dependence on deliveries from Metropolitan during periods of high demand, emergencies or shortages.

Each participating agency must demonstrate that water is "stored" by taking imported supplies over and above its actual demands for that year and storing the water for the duration of the year for which deliveries are certified. If the water is not stored for the required time (e.g., water cycled into and out of storage in the same year), full service deliveries could be inappropriately displaced and the discounted rate would be disallowed.

Historically, Replenishment Service was frequently available and administered in accordance with Metropolitan's Water Surplus and Drought Management (WSDM) Plan, adopted by the Board in 1999. The WSDM Plan provides guidelines for how replenishment deliveries fit into Metropolitan's other surplus and drought management actions. In accordance with the WSDM Plan, replenishment deliveries were available every year since the plan was adopted and weren't suspended until May 2007, due to an extended dry period, regulatory

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restrictions on exports from the Delta, and depletion of Metropolitan's regional storage in accordance with the WSDM Plan, as shown in the figure below.



Other Groundwater Programs

As replenishment deliveries have been made over the past several decades, other Metropolitan groundwater programs were developed to respond to the increasing need for additional dry year supplies and operational flexibility. The groundwater conjunctive use program and Supplemental Storage Program were developed as early as the 1990's and implemented as contractual agreements between Metropolitan and participating member agencies. These agreements allow Metropolitan to store available imported water in groundwater basins and to withdraw that stored water in dry years at its call. These contractual storage programs provided assured dry year supplies for the region. In addition, cyclic storage agreements were developed beginning in the 1970's to increase Metropolitan's operational flexibility by providing Metropolitan with the ability to deliver water for replenishment when it is available in wet periods and the ability to curtail the delivery of replenishment water when supplies are restricted.

Revisions to the Program

At its May 2011 meeting, the Board provided direction to the General Manager to exercise his discretion to make about 225,000 acre-feet of deliveries available under the existing Replenishment Service Program. Additionally, the Board requested that staff develop options and a recommendation to revise the Replenishment Service Program in a manner that enhances regional reliability, complements the other groundwater programs, and improves operational flexibility to manage changes in hydrology, contracts and regulatory requirements.

Several factors should be considered in the development of these options, including:

- The potential for the program to provide regional benefits in dry years
- The frequency and magnitude of surplus conditions in the future
- The increased size and diversification of Metropolitan's regional storage portfolio

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- The potential operational benefits of the program (e.g. interruptibility and system capacity benefits)
- The linkage between the level of regional benefits and any related financial incentives

Regional Benefits

The current Replenishment Service Program provides a discount below the full service rate to incentivize local storage when favorable imported supplies and system capacity are available. This is intended to allow participating agencies to increase local production in a later dry period, making more imported supplies available for other agencies. Therefore, Metropolitan receives the benefits of being able to deliver water when supply and capacity are available and to interrupt these deliveries when they are unavailable. The participating agency receives a benefit of increased local production and a discounted interruptible water rate.

However, unless the increased local production (and subsequent reduction in imported water deliveries to the agency) occurs when it is needed by the region to offset dry-year conditions, the benefits of discounted deliveries into storage could be reduced. This type of operation could lead to discount Replenishment sales offsetting full-service water sales without any corresponding regional dry-year benefit. As a result of lessons learned with previous replenishment programs, refinement of several regional benefit features for an interruptible Replenishment Program have been identified. For example:

- Measurable dry-year reliability enhancement
- Increased operational flexibility through interruptible deliveries
- Increased delivery of surplus imported supplies into the region when available

Since each of these features provides different degrees of regional reliability, a revised program should recognize that agencies may be able to provide only one, two or all of the benefits. As such, a future program should acknowledge one or more of these features, and provide incentives that are proportional to the magnitude of regional benefit.

Principles for a Revised Program

Key features of a revised program, featuring improved regional benefit, can be summarized with the following set of principles to guide policy development:

Regional Benefits: The program should provide regional benefits, including: (1) dry-year supplies at Metropolitan's call, (2) flexibility to manage delivery of available supplies in a way that would provide additional storage beyond Metropolitan's regional storage capability, and (3) delivery of supplies available to Metropolitan that are otherwise at risk of spill or loss.

Equity for Member Agencies: The program will be available to all member agencies and provide quantifiable regional benefits.

Financial Integrity: The program options should support the stability of Metropolitan's revenues and coverage of costs.

Regional Value: Program incentives should be based on sound economic principles and be proportional to the water management benefits provided.

Operational Flexibility: The program will enhance opportunities for Metropolitan to effectively manage water supplies under varied water supply conditions.

Complementary with Other Storage Programs: Features of the program should be complementary with existing storage programs, such that past investments continue to yield reliability benefits.

Next Steps

Proposed policy principles to revise the Replenishment Service Program will be presented for Board consideration in November 2011. This will be followed by options and recommendations for a revised program, based on the policy principles approved in November, for board consideration in December 2011.