



- Board of Directors
Finance and Insurance Committee

11/18/2014 Board Meeting

8-1

Subject

Approve the proposed terms for Purchase Orders with Member Agencies; authorize the General Manager to execute Purchase Orders with Member Agencies consistent with the proposed terms; and approve the Proposed Amendments to the Administrative Code

Executive Summary

The Board is asked to approve the proposed terms for Purchase Orders with member agencies as outlined in [Attachment 1](#), authorize the General Manager to execute Purchase Orders with member agencies consistent with the proposed terms, and approve the proposed amendments to the Administrative Code as shown in [Attachment 3](#). The Purchase Orders will allow member agencies to purchase greater amounts of Metropolitan system water at the Tier 1 Supply Rate in exchange for a commitment to purchase a specific amount of water at a minimum over time which provides Metropolitan with a measure of revenue certainty over the term of the agreements.

Details

Purchase Orders are voluntary agreements that determine the amount of water that a member agency can purchase at the Tier 1 Supply Rate. They allow member agencies to purchase a greater amount of water at the lower Tier 1 Supply Rate than would otherwise be authorized by the Administrative Code. In exchange for the higher Tier 1 Maximum, the member agency commits to purchase a specific amount of water (based on past purchase levels) over the term of the agreement. Such agreements allow member agencies to manage costs and provide Metropolitan with a measure of secure revenue.

As previously explained to the Board and as further clarified below, Purchase Orders are adjuncts to the cost-of-service study in that they implement Metropolitan's tiered supply pricing structure. Metropolitan's current cost-of-service study, as well as the current budget and rates, assume no Tier 2 sales. If received, Tier 2 revenue will be used towards the incremental cost of acquiring additional water supplies to serve users with increasing demands and to fund additional conservation efforts. The Tier 2 Supply Rate also encourages efficient water resource management and conservation by indicating to member agencies the increased costs associated with demand increases. Purchase Orders also allow member agencies to maintain and manage local supplies by, for example, removing possible replenishment disincentives.

The existing Amended and Restated Purchase Order agreements, entered into with 22 member agencies, expire on December 31, 2014. Through discussions with the Board and the member agencies, a proposal was developed for new ten-year Purchase Orders. The key terms of the new Purchase Orders are outlined in greater detail in [Attachment 1](#), and include:

- A ten-year term, effective January 1, 2015 through December 31, 2024;
- For member agencies executing a Purchase Order, the choice between the demand base of the current Amended and Restated Purchase Order agreements, which is the highest fiscal year purchases during the 13-year period of FY 1990 through FY 2002, or the highest year in the most recent 12-year period of

FY 2003 through FY 2014. The demand base is unique for each member agency, reflecting its use of Metropolitan's system water over time;

- An overall purchase commitment by the member agency based on the demand base period chosen, times ten to reflect the ten-year Purchase Order term. Those agencies choosing the more recent 12-year period may have a higher Tier 1 Maximum and commitment. The commitment is also unique for each member agency;
- The opportunity to reset the base period demand using a five-year rolling average;
- Any obligation to pay the Tier 2 Supply Rate will be calculated over the ten-year period, consistent with the calculation of any Purchase Order commitment obligation; and
- An appeals process for agencies with unmet purchase commitments that will allow each acre-foot of unmet commitment to be reduced by the amount of production from a local resource project that commences operation on or after January 1, 2014.

The Administrative Code provides that a member agency's Tier 1 Maximum is 60 percent of their calculated Revised Base Firm Demand. Each member agency's Revised Base Firm Demand is shown in Administrative Code Section 4122. Under the Purchase Orders, member agencies will have the option to purchase a greater amount of water at the lower Tier 1 Supply Rate in exchange for a commitment to purchase a minimum amount of water over the term of the Purchase Order. The current sum of the Tier 1 Maximum for member agencies, with and without Purchase Orders, totals 2.05 million acre-feet (MAF) for Calendar Year 2014. Discussions with member agencies regarding possible new Purchase Orders indicate that the total sum of the Tier 1 Maximum amounts is expected to remain at approximately 2.05 MAF. The current sum of the annual average commitment for member agencies with a Purchase Order total approximately 0.9 MAF; the total sum of the annual average commitment for member agencies anticipated to execute a new Purchase Order is also expected to remain at approximately 0.9 MAF.

Some member agencies use Metropolitan as a full requirements provider, some use Metropolitan as a partial requirements provider, and some member agencies use Metropolitan for standby service. The cost-of-service analyses and the resulting Readiness-to-Serve Charge, Capacity Charge, and volumetric rates capture the costs of these varying needs. Tiered supply rates, however, allow Metropolitan to cover higher incremental resource costs to supply users with increasing demands. Tier 2 revenues realized in the current or future biennial budget period will be transferred to the Water Management Fund to cover these higher incremental resources costs, including North of Delta transfers, as well as additional conservation expenses to address the increased demand and mitigate its impact.

For member agencies that sign new Purchase Orders and commit to purchase a minimum amount of water, their obligation to pay the Tier 2 Supply Rate will be calculated over the term of the Purchase Order, consistent with the calculation of the commitment obligation. In this way, the Purchase Order focuses any Tier 2 obligation on agencies with demands that are increasing or agencies that are unable to maintain local resources on an ongoing basis, rather than hydrologic variations which are accommodated in Metropolitan's current supply portfolio and financial reserves. Calculating member agencies' Tier 2 obligations over the entire term also accommodates responsible and sustainable water management by member agencies that may be cost prohibitive if Tier 2 obligations were calculated annually. For example, the cumulative calculation of any Tier 2 obligation allows member agencies with Purchase Orders to take large amounts of water in a short period of time in order to replenish storage but still stay within their Tier 1 base demand as long as they manage their deliveries over the long term.

Member agencies that accrue a Tier 2 obligation by virtue of exceeding their Tier 1 Maximum at the end of year five of the Purchase Order will pay their Tier 2 obligation annually. Any member agency without a Purchase Order must pay their Tier 2 obligation in the calendar year in which it accrues.

Member agencies give their prospective commitments considerable deliberation when determining whether to sign a Purchase Order or not. Their commitment to purchase system water from Metropolitan over the term

provides a level of assurance between the member agency and Metropolitan, and among the member agencies, that revenues will be generated. In particular, the Purchase Order commitment provides a level of assurance among the member agencies that participating agencies will share in the costs of supporting Metropolitan, as determined by cost-of-service analyses.

Attachment 2 summarizes each member agency's options.

Attachment 3 includes the proposed changes to the Administrative Code in strike-through and underline format to incorporate the new Purchase Order.

Purchase Orders are voluntary and do not confer a contractual right to system water to a member agency. The Tier 1 and Tier 2 Supply Rates for Calendar Years 2015 and 2016 have already been determined by the Board. Biennially, the Board reviews the proposed Tier 1 and Tier 2 Supply Rates as part of the biennial rate setting process.

Policy

Metropolitan Water District Administrative Code Section 4120: Purchase Order; Purchase Order Commitment

Metropolitan Water District Administrative Code Section 4122: Base Period Demand; Revised Base Firm Demand; Initial Base Firm Demand;

Metropolitan Water District Administrative Code Section 4404: Purchase Orders

California Environmental Quality Act (CEQA)

CEQA determination for Option #1:

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). In addition, where it can be seen with certainty that there is no possibility that the proposed action in question may have a significant effect on the environment, the proposed action is not subject to CEQA (Section 15061(b)(3) of the State CEQA Guidelines).

The CEQA determination is: Determine that the proposed action is not defined as a project and is not subject to CEQA pursuant to Sections 15378(b)(2), 15378(b)(4), and 15061(b)(3) of the State CEQA Guidelines.

CEQA determination for Option #2:

None required

Board Options

Option #1

Adopt the CEQA determination that the proposed action is not defined as a project and is not subject to CEQA, and

- a. Approve the proposed terms for Purchase Orders with member agencies as outlined in **Attachment 1**;
- b. Authorize the General Manager to execute the Purchase Order with member agencies opting to execute the Purchase Order consistent with the proposed terms, in a form approved by the General Counsel; and
- c. Approve amendment of Sections 4120, 4122, 4401, 4404, and 4507 of the Administrative Code as shown in **Attachment 3**.

Fiscal Impact: The Purchase Orders will have no fiscal impact in FY 2014/15 and FY 2015/16; the biennial budget assumes 1.75 MAF of sales in each fiscal year, with no Tier 2 purchases.


Option #2

Do not approve the proposed terms for Purchase Orders with member agencies, do not authorize the General Manager to execute the Purchase Order, and do not approve changes to the Administrative Code.

Fiscal Impact: Unknown

Staff Recommendation

Option #1



Gary Breaux
Chief Financial Officer

11/3/2014
Date



Jeffrey Kightlinger
General Manager

11/5/2014
Date

Attachment 1 – Purchase Order for System Water to be Provided by the Metropolitan Water District of Southern California: Key Terms

Attachment 2 – Tier 1 Maximum and Commitment Options

Attachment 3 – Proposed Amendments to Administrative Code

Ref# cfo12633440

**Purchase Order for System Water to be Provided by the
Metropolitan Water District of Southern California
Key Terms**

Term:

- 10 years, effective January 1, 2015 through December 31, 2024

Base Period:

- For purposes of determining their Tier 1 maximum, member agencies can choose between the current Revised Base Firm Demand, which is the highest fiscal year sales during the 13-year period of FY 1990 through FY 2002, **OR** the highest year in the most recent 12-year period of FY 2003 through FY 2014. Both calculations include Interim Agricultural Water Program, Seasonal Storage Service—Long, Cyclic and Replenishment Program sales.
 - Member agencies executing Purchase Orders will have a Tier 1 Maximum based on 90% of the respective base period peak year they choose.
 - If a member agency opts to use the original 13-year period for their Purchase Order, their commitment will be 60% of the 2003 Initial Base Firm Demand (same as current Purchase Order).
 - If a member agency opts to use the more recent 12-year period for their Purchase Order, their commitment will be 60% of the highest year in the most recent 12-year period.
 - Member agencies who do not execute a Purchase Order will have their Tier 1 limit set at 60% of the Revised Base Firm Demand (same as current Purchase Order).
 - The calculation of the rolling average for purposes of resetting the Tier 1 maximum will exclude Water Supply Allocation Plan years and will use a 5-year period. Once the Tier 1 Maximum resets, this reset will not go down.

Tier 2 Applicability:

- Tier 2 should only be applied to a member agency if its cumulative sales for the term of the Purchase Order exceed its cumulative Tier 1 Maximum, consistent with the methodology currently utilized to satisfy the 60 percent Purchase Order commitment.
- Member agencies with Tier 2 obligations may choose:
 - To have the obligation calculated at the end of the 10-year term and pay any Tier 2 obligations at that time, based on the average of the difference between the Tier 1 and Tier 2 Supply Rates over the 10-year term.
 - To pay any Tier 2 obligations as they are incurred, with a true-up at the end of the 10-year period.
 - If, after Year 5, a Purchaser has accrued a Tier 2 obligation (purchases exceed the Tier 1 Maximum annualized * 5), the Purchaser will begin paying any future Tier 2 obligation annually. Any outstanding Tier 2 obligation owing from the initial 5-year period can be amortized over the next 5 calendar years or paid at termination of the Purchase Order.

Additional Aspects of the Purchase Orders:

- Purchase Orders are voluntary
- The commitment is cumulative over the term; agencies that do not meet the full amount of the commitment during the term will pay for the unmet commitment at the average of the Tier 1 Supply Rate in effect during the term. The Purchase Order will allow for an appeals process at the end of the term for agencies with an unmet commitment. Each acre-foot of unmet commitment will be reduced by the amount of production from a local resource project, measured in acre-feet, that commences operation on or after January 1, 2014. Local resource production includes any project type as approved by the Board under the Local Resources Program.
- The commitment will be adjusted to exclude Water Supply Allocation Plan years.
- Purchase Orders do not confer a contractual right to system supply to a member agency. The proposal does not accommodate the exchange or sale of purchase order quantities between member agencies.
- All member agency purchase orders will extend over the same 10-year period. Member agencies purchase orders will be effective January 1, 2015.
- The Tier 2 Supply Rate for Calendar Years 2015 and 2016, as already determined by the Board, will not change. Biennially, the Board reviews the proposed Tier 1 and Tier 2 Supply Rates as part of the biennial rate setting process.

Tier 1 Maximum and Commitment Options

Member Agency	Current Base (FY 1990-2002)			Updated Base (FY 2003-2014)		Tier 1 Maximum without PO (60% Revised BFD)		
	2003 IBFD	2014 Revised BFD	12-Year Peak (FY 2003-14)	Commitment with PO (60% 2003 IBFD)	Tier 1 Maximum with PO (90% 2014 Revised BFD)		Commitment with PO (60% 12-Year Peak)	Tier 1 Maximum with PO (90% 12-Year Peak)
Anaheim	24,711	27,154	31,271	14,827	24,439	18,763	28,144	16,292
Beverly Hills	14,867	14,867	13,178	8,920	13,380	7,907	11,860	8,920
Burbank	18,152	18,640	15,817	10,891	16,776	9,490	14,235	11,184
Calleguas	115,334	122,498	131,364	69,200	110,248	78,819	118,228	73,499
Central Basin	80,401	119,617	119,237	48,241	107,655	71,542	107,313	71,770
Compton	5,620	5,620	3,695	3,372	5,058	2,217	3,325	3,372
Eastern	84,111	102,694	130,650	50,466	92,425	78,390	117,585	61,616
Foothill	12,219	13,081	14,831	7,331	11,773	8,899	13,348	7,849
Fullerton	12,554	12,554	17,795	7,532	11,299	10,677	16,015	7,532
Glendale	29,135	29,135	23,829	17,481	26,222	14,297	21,446	17,481
Inland Empire	66,391	103,648	97,157	39,835	93,283	58,294	87,441	62,189
Las Virgenes	22,851	22,999	27,065	13,710	20,699	16,239	24,358	13,799
Long Beach	43,857	57,560	47,565	26,314	51,804	28,539	42,809	34,536
Los Angeles	338,855	372,959	441,871	203,313	335,663	265,123	397,684	223,775
MWDOC	247,694	311,769	357,372	148,616	280,592	214,423	321,635	187,061
Pasadena	23,533	23,533	25,517	14,120	21,180	15,310	22,965	14,120
San Diego CWA	557,095	655,903	637,487	334,257	590,313	382,492	573,738	393,542
San Fernando	1,050	1,049	902	630	944	541	812	629
San Marino	1,998	1,998	1,602	1,199	1,798	961	1,442	1,199
Santa Ana	13,476	21,797	22,007	8,086	19,617	13,204	19,807	13,078
Santa Monica	12,344	12,344	14,444	7,406	11,110	8,666	12,999	7,406
Three Valleys	78,222	83,248	89,653	46,933	74,923	53,792	80,687	49,949
Torrance	23,297	23,297	21,338	13,978	20,967	12,803	19,204	13,978
Upper San Gabriel	18,346	74,698	75,566	11,008	67,228	45,339	68,009	44,819
West Basin	174,304	175,024	150,464	104,583	157,522	90,278	135,417	105,014
Western MWD	65,299	94,567	117,537	39,179	85,110	70,522	105,784	56,740
TOTAL	2,085,713	2,502,253	2,629,212	1,251,428	2,252,028	1,577,527	2,366,291	1,501,352

§ 4120. Purchase Order; Purchase Order Commitment.

“Purchase Order” shall mean a member agency’s written commitment to purchase a specified total volume of water from the District during a specified period, as provided in Section 4404. ~~and~~ “Purchase Order Commitment” shall mean ~~60% of a member agency’s Initial Base Firm Demand times the number of years in the term of the Purchase Order. Deliveries of surplus system water supplies, including, but not limited to, deliveries under the Interim Agricultural Water Program and Replenishment Service, will not count toward the Purchase Order commitment the amount of system water a member agency commits to purchase over the term of the Purchase Order.~~

M. I. 44812 - March 12, 2002; amended by M. I. 45249 - March 11, 2003.

§ 4122. Base Firm-Period Demand; Initial- Revised Base Firm Demand; Initial Base Firm Demand.

“Base Firm-Period Demand” shall mean the amount specified in a member agency’s Purchase Order, that is either: the greater of a) the member agency’s Initial- Revised Base Firm Demand, as specified in this Section; or b) the member agency’s highest fiscal year purchases from fiscal year 2003 through 2014; provided, however, that if ~~or b)~~ the member agency’s ~~ten~~ five-fiscal year rolling average of ~~deliveries-purchases~~ of water from the District for the most recent ~~ten~~ five fiscal year period, excluding, ~~in either case,~~ water ~~delivered under Long-Term Seasonal Storage Service or Replenishment Service, whichever is applicable~~ purchased under an interruptible program, ~~exceeds the member agency’s initial Base Period Demand, then the member agency’s Base Period Demand for each subsequent calendar year shall be increased to the member agency’s five-fiscal year rolling average. and Interim Agricultural Water Program Service,~~ and “Initial Base Firm Demand” shall mean the member agency’s highest annual delivery of water from the District, excluding water delivered under Long-Term Seasonal Storage Service, Interruptible Service, and Interim Agricultural Water Program Service, during any fiscal year from fiscal year 1989/90 through fiscal year 2001/02.

~~Effective as of January 1, 2013, “Base Firm Demand” shall mean the greater of a) the member agency’s Initial Base Firm Demand Post IAWP or b) the member agency’s ten fiscal year rolling average of deliveries of water from the District for the most recent ten fiscal year period, excluding water delivered under Interim Agricultural Water Program Service and any other non-firm water delivery, and “Initial Base Firm Demand Post IAWP” shall mean the member agency’s highest annual delivery of water from the District, excluding water delivered under the Long-Term Seasonal Storage Service and Interruptible Service programs but including water delivered under Interim Agricultural Water Program Service, during any fiscal year from fiscal year 1989/90 through fiscal year 2001/02.~~

Effective as of January 1, 2013, each member agency's ~~Initial Revised~~ Base Firm Demand ~~Post IAWP (further adjusted for elimination of Replenishment Service after 2012)~~ is as follows:

<u>Member Agency</u>	<u>Revised IBFD Post IAWP</u>
<u>Anaheim</u>	27,154
<u>Beverly Hills</u>	14,867
<u>Burbank</u>	18,640
<u>Calleguas</u>	122,498
<u>Central Basin</u>	119,617
<u>Compton</u>	5,620
<u>Eastern</u>	102,694
<u>Foothill</u>	13,081
<u>Fullerton</u>	12,554
<u>Glendale</u>	29,135
<u>Inland Empire</u>	103,648
<u>Las Virgenes</u>	22,999
<u>Long Beach</u>	57,560
<u>Los Angeles</u>	372,959
<u>MWDOC</u>	311,769
<u>Pasadena</u>	23,533
<u>San Diego</u>	655,903
<u>San Fernando</u>	1,049
<u>San Marino</u>	1,998
<u>Santa Ana</u>	21,797
<u>Santa Monica</u>	12,344
<u>Three Valleys</u>	83,248
<u>Torrance</u>	23,297
<u>Upper San Gabriel</u>	74,698
<u>West Basin</u>	175,024
<u>Western</u>	94,567

§ 4401. Rates.

Supply Rate:

Tier 1 Supply Rate – The Tier 1 Supply Rate shall apply to water purchases which in the aggregate for any calendar year, are less than or equal to 60 percent of the Revised Base Firm Demand of such member agency as specified in Section 4122, unless that member agency has executed a Purchase Order, as defined in Section 4120, in which case the Tier 1 Supply Rate applies to water purchases as established by the Purchase Order terms. ~~(or, if the~~

~~member agency purchasing the water has executed a Purchase Order, 90 percent) of the Base Firm Demand of such member agency.~~

Tier 2 Supply Rate –The Tier 2 Supply Rate shall apply when a member agency’s cumulative total of ~~full service deliveries~~water purchases for the calendar year exceeds 60 percent of the member agency’s Revised Base Firm Demand as specified in Section 4122, or according to the terms of a Purchase Order 90 percent of Base Firm Demand for member public agencies that execute a Purchase Order.

§ 4404. Purchase Orders.

(a) The General Manager shall establish and make available to member public agencies the form of the Purchase Order and procedures for its administration. The General Manager shall establish a deadline by which all Purchase Orders shall be executed by member public agencies that desire to enter into such agreements with the District. Following the deadline established by the General Manager, no member public agencies will be allowed to execute Purchase Orders.

(b) The term of the ~~initial~~ Purchase Orders shall be ~~from January 1, 2003 through and including December 31, 2012~~specified in the Purchase Order. All Purchase Orders in effect ~~for the same time period shall be on substantially the same terms. shall be on substantially the same terms and for the same term. Any All~~ amendments to Purchase Orders ~~shall be subject to~~require approval by the Board.

(c) Each member public agency executing a Purchase Order shall commit to purchase at least its Purchase Order Commitment during the term of the Purchase Order.

(d) Purchase Orders shall permit A member public agency ~~that executed a Purchase Order shall be permitted annually~~ to purchase up to 90 percent of its Base Firm-Period Demand at the Tier 1 Supply Rate for the term of the Purchase Order.

~~(e) —When a member public agency has purchased at least its Purchase Order Commitment the minimum purchase requirement of the Purchase Order will be fulfilled.~~

~~(f) If, upon expiration of the term of the Purchase Order, a member agency has purchased an amount of water less than its Purchase Order Commitment, the member public agency shall pay Metropolitan an amount equal to the difference between its Purchase Order Commitment and its actual purchases during the term of the Purchase Order, times the Tier 1 Supply Rate in effect in the last year of the Purchase Order term.~~

~~(g)~~(e) All water deliveries under a Purchase Order shall be subject to the operational conditions and constraints contained in this Division. In ~~Addition~~addition, all billings and payments for such water shall be subject to the provisions of this Division in the same manner as other water delivered by Metropolitan.

§ 4507. Billing and Payment for Water Deliveries.

~~(p) **Supply Rates.** Deliveries to a member public agency shall be charged at the Tier 2 Supply Rate when the cumulative total of full service deliveries to the member public agency for the year exceeds 60 percent of the member agency's Base Firm Demand. A member public agency that executed a Purchase Order shall be charged at the Tier 2 Supply Rate when the cumulative total of full service deliveries to the member public agency for the year exceeds 90 percent of the member public agency's Base Firm Demand.~~