

- **Board of Directors**

October 16, 2001 Board Meeting

9-6

Subject

Approve Rate Structure Proposal

Description

Background

On September 10, 2001, the Subcommittee on Rate Structure Implementation (Subcommittee) considered a proposal by several member agency managers (Calleguas Municipal Water District, Eastern Municipal Water District, the City of Los Angeles, Central Basin Municipal Water District and West Basin Municipal Water District) to implement Metropolitan's new rate structure in a manner consistent with the Rate Structure Action Plan that was adopted by the Board in December 2000. This proposal addressed many of the concerns raised by Board members during the past nine months as the Subcommittee reviewed the December Action Plan, including the use of property taxes, financial impacts, the relative burden of financial risk, financial commitment and water resource management. The details of the Member Agency Managers' Proposal (Proposal) is included in [Attachment 1](#).

The Subcommittee then reviewed staff's evaluation of the Proposal at the Subcommittee's September 18, 2001 meeting. On September 25, 2001, the Board held a Board Workshop on the Proposal. At that meeting, the Board considered a number of questions raised by the Subcommittee (see [Attachment 2](#)), as well as the Board, and directed staff to agendize the Proposal for Board action at the October 16, 2001, Board meeting.

The proposed rate structure is consistent with the Board's Strategic Plan Policy Principles, which were adopted in December 1999. The Proposal furthers Metropolitan's strategic objectives, supports and encourages sound water resource management, accommodates a water transfer market, enhances fiscal stability and is based on cost-of-service principles. An analysis of the Proposal and its consistency with the Board's Principles from December 1999 is shown in [Attachment 3](#).

Summary of Proposal

Tiered Rate Structure. The Proposal retains the two-tiered pricing structure included in the Rate Structure Implementation Plan from December 2000. Such a pricing structure encourages efficient water resource management and conservation. The amount of water supply that a member agency may purchase in any one year at the lower Tier 1 rate is determined by two factors – the amount of firm water (basic and shift) purchased since fiscal year 1989/90 and the member agency's election to submit a voluntary purchase order for a ten-year supply of water.

A base level of consumption will be established for each member agency equal to the member agency's highest fiscal year firm demand since 1989/90. Member agencies will be able to submit a voluntary purchase order to purchase a minimum amount of water over the next ten years equal to 60 percent of this base times 10. The member agency has ten years to purchase this minimum quantity and can vary its purchase amounts from year to year. But, the member agency would be obligated to pay for the full purchase order, even if it did not use the full amount at the end of the ten-year period. In exchange for this minimum commitment, the member agency will be able to purchase an amount of water supply equal to ninety-percent of the base in any given year at the lower Tier 1 rate. Agencies that determined that a purchase order was not in their interest would be able to purchase up to 60 percent of their base at the lower Tier 1 rate.

Unbundled Rates and Charges. As described in the December Action Plan, rates and charges would be unbundled to reflect the different services provided by Metropolitan. Specifically, the following rate elements would be part of the Proposal:

- a. **Tier 2 supply rate.** The Tier 2 Supply Rate would be charged on a dollar per acre-foot basis for system supply delivered in excess of 90 percent of a member agency's base for member agencies with purchase orders. The Tier 2 Supply Rate would be charged for system supply delivered in excess of 60 percent of a member agency's base for member agencies without purchase orders. The Tier 2 Supply Rate would be set at a level that reflects Metropolitan's cost of acquiring new supplies.
- b. **Tier 1 supply rate.** The Tier 1 Supply Rate would be charged on a dollar per acre-foot basis for system supply delivered to meet firm demands that are less than 90 percent of a member agency's base for member agencies with purchase orders. The Tier 1 Supply Rate would be charged to system supply deliveries that are less than 60 percent of a member agency's base for member agencies without purchase orders. The Tier 1 Supply Rate would be set to recover all of Metropolitan's supply costs, except those paid through the Tier 2 Supply Rate and a portion of the long-term storage and agricultural water sales.
- c. **System Access Rate.** The System Access Rate would be charged on a dollar per acre-foot basis and collect the costs associated with the conveyance and distribution system, including capital, operating and maintenance costs. The System Access Rate would be charged for every acre-foot of water conveyed by Metropolitan. All users (including member agencies and third-party wheeling entities) of the Metropolitan system would pay the same rate for conveyance).
- d. **Water Stewardship Rate.** A Water Stewardship Rate would be charged on a dollar per acre-foot basis to collect revenues in support of Metropolitan's financial commitment to conservation, water recycling, groundwater recovery and other water management programs approved by the Board. The Water Stewardship Rate would be charged for every acre-foot of water conveyed by Metropolitan.
- e. **System Power Rate.** The System Power Rate would be charged on a dollar per acre-foot basis to recover the cost of power necessary to pump water from the State Water Project and Colorado River through the conveyance and distribution system for Metropolitan's member agencies. The System Power Rate will be charged for all Metropolitan supplies. Entities wheeling water would continue to pay the actual cost of power to wheel water on the State Water Project, the Colorado River Aqueduct or the Metropolitan distribution system, whichever is applicable.
- f. **Treatment Rate.** Metropolitan would continue to charge a treatment rate on a dollar per acre-foot basis for treated deliveries. The treatment rate would be set to recover the cost of providing treated water service, including capital and operating cost.
- g. **Capacity Reservation Charge and Peaking Surcharge.** Member agencies would pay a Capacity Reservation Charge (set in dollars per cubic feet per second of the peak day capacity they reserved). The Capacity Reservation Charge is a fixed charge levied on an amount of capacity reserved by the member agency. The Capacity Reservation Charge recovers the cost of providing peak capacity within the distribution system. Peak-day deliveries in excess of the reserved amount of capacity chosen by the member agency would be assessed a Peaking Surcharge. Peaking Surcharge revenue collected by Metropolitan for the three fiscal years ending on June 30, 2005, would be refunded to that member agency to implement specific capital projects and programs to avoid peaking charges in the future. The Capacity Reservation Charge and Peaking Surcharge are designed to encourage member agencies to continue to shift monthly demands into the winter months and avoid placing large daily peaks on the Metropolitan system. Daily flow measured between May 1 and September 30 for purposes of billing the Capacity Reservation Charge and Peaking Surcharge will include all deliveries made by Metropolitan to a member agency or member agency customer including water transfers and agricultural deliveries.
- h. **Readiness-to-Serve Charge.** Metropolitan's Readiness-to-Serve Charge would recover costs associated with standby and peak conveyance capacity and system emergency storage capacity. The Readiness-to-Serve Charge would be allocated among the member agencies on the basis of each agency's ten-year rolling average

of firm demands (including water transfers wheeled through system capacity). This allocation would be revised each year. At the request of the member agency, revenues equal to the amount of Standby Charges would continue to be credited against the member agency's Readiness-to-Serve Charge obligation.

- i. **Long-term storage service program.** The current long-term storage service program used by the member agencies for storage replenishment purposes would continue as is. The long-term storage rate would also remain a bundled rate. The long-term rate would be reviewed annually by the Board as part of the regular rate cycle. Although the Proposal recommends that the long-term storage service program remain in place for at least the next ten years, the Board retains the ability to reexamine this program as needed.
- j. **Agricultural water program.** The current surplus water agricultural service program used by the member agencies for agricultural purposes would remain in place. The agricultural rate would also remain a bundled rate. The agricultural rate will be reviewed annually by the Board as part of the regular rate cycle. Although the Proposal recommends that the current agricultural program remain in place for at least the next ten years, the Board retains the ability to reexamine this program as needed.

Addressing New Demands. The Proposal addresses the impact of new demands on the cost of water supply through the tiered rate structure. Agencies that have increasing demands on Metropolitan would pay more, since they would purchase a greater share of the water sold at the higher Tier 2 rate. In addition, the Proposal provides that a mechanism to recover costs for Metropolitan's infrastructure associated with increasing system demands will be developed and in place by 2006.

Financial Impact

Financial Impact to Member Agencies. While the Proposal includes a number of changes to Metropolitan's existing structure, the initial financial impacts as a result of the change are estimated to be less than three percent (plus or minus), on any one member agency when compared to the existing rate structure. These impacts are estimated in fiscal year 2002/03 and assume normal demand conditions. Over time, it is expected that agencies using more Metropolitan supplies will purchase a greater share of water at the higher Tier 2 rate and would pay more.

Financial Impact to Metropolitan. The total amount of revenue generated under the Proposal would be the same as that under the proposed structure. The introduction of the purchase order helps to provide additional certainty regarding Metropolitan's base supply. But, the purchase order is flexible enough that member agencies do not take on undue financial risk. In addition, the Capacity Reservation Charge adds to fixed revenues.

Impact on Water Transfers. The Proposal provides clear price signals that reflect Metropolitan's costs (both to develop new supplies and to transport water). As such, cost-effective water transfers by Metropolitan and others would be facilitated by this rate structure.

Implementation Plan

If the Board approves the Proposal, a report would be prepared describing each of the above rate design elements in detail, including the cost of service used to develop the rates and charges. The Chief Executive Officer would recommend the rates and charges to the Board in January of 2002. A public hearing on the rates and charges implementing the Proposal would be held at the February 2002 Board meeting. The Board would take action to adopt the rates and charges in March of 2002. The rates and charges as described in the report and recommended by the Chief Executive Officer would be effective January 1, 2003. A Resolution to Adopt the Rate Structure Proposal is provided as [Attachment 4](#).

Policy

The Proposal is consistent with the Board's Strategic Plan Policy Principles and addresses concerns raised by the Board regarding the December 2000 Rate Structure Action Plan.

CEQA

The proposed action, i.e., approval of the Proposal, is not defined as a project under the California Environmental Quality Act (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 the creation of government funding mechanisms or 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).

The CEQA determination is: Determine that the proposed action is not subject to CEQA per Sections 15378(b)(2) and 15378(b)(4) of the State CEQA Guidelines.

Board Options/Fiscal Impacts

Option #1

Adopt the CEQA determination and Resolution approving the Proposal and direct staff to take the necessary steps to implement rates and charges as defined by the Proposal to be effective January 1, 2003.

Fiscal Impact: Increased fixed revenue and financial commitment from member agencies. Total amount of revenue recovered from the member agencies will be the same.

Option #2

Defer consideration of the Proposal until further discussion by the Board.

Fiscal Impact: None

Staff Recommendation

Option #1

	10/9/2001
_____ Brian G. Thomas Chief Financial Officer	Date

	10/9/2001
_____ Ronald R. Gastelum Chief Executive Officer	Date

Attachment 1 - Member Agency Managers' Proposal MWD Rate Structure

Attachment 2 - Subcommittee on Rate Structure Implementation Responses to Subcommittee Questions

Attachment 3 - Comparison between Member Agency Managers' Rate Structure Proposal and Metropolitan's Board Principles

Attachment 4 - Resolution to Adopt Rate Structure Proposal

**MEMBER AGENCY MANAGERS' PROPOSAL
MWD RATE STRUCTURE
(PROPOSAL)**

(AS SUBMITTED TO THE BOARD SEPTEMBER 25, 2001)

OVERVIEW

Objectives

The proposed rate structure is a pricing mechanism to achieve the following objectives:

- Maintain MWD as the regional provider of imported water – MWD, working collaboratively with its member agencies, will secure necessary water supplies and build appropriate infrastructure to meet current and future needs of its member agencies.
- Support cost-effective local resources development and water conservation – MWD will continue to help fund cost-effective water recycling, groundwater recovery, and water conservation.
- Accommodate a water market – By unbundling its water rate, MWD will accommodate a water market.

Proposed Rate Structure

In order to support MWD's strategic vision, member agencies have developed a rate structure proposal, which is consistent with MWD's Board's December 2000 action plan. This rate structure has the following components:

1. Unbundles water rate into five separate commodity rates: (1) supply; (2) system access, for conveyance and distribution; (3) water stewardship; (4) power; and (5) treatment.
2. Supply rate has two tiers.
3. Two fixed charges: (1) Readiness to Serve Charge (RTS), to help pay for emergency storage and standby for conveyance; and (2) Capacity Reservation Charge, to help pay for peaking for distribution.
4. Voluntary Purchase Order requests for firm water deliveries.
5. Surplus water, when available, for local long-term storage replenishment and agricultural deliveries.

Benefits of Rate Structure

The proposed rate structure offers the following benefits:

- ***Unbundled rates charge all users for system access on same basis.*** Separating supply costs enables MWD to treat everyone on equal basis (member agencies, retail providers, third parties), and is the first step in accommodating a water market.
- ***Tiered supply rates provides pricing signals for water users with increasing demands and incentives to maintain existing local supplies.*** Tiered water supply rates: (1) reflect higher costs of new MWD supply development; (2) signals users when local resources development and conservation might be more cost-effective; and (3) passes appropriate costs of new supply development to those member agencies that rely on MWD for growing demands.
- ***Voluntary Purchase Orders provide for commitment while protecting regional reliability to all.*** Purchase Orders are: (1) voluntary; (2) offer price incentives to member agencies by allowing more water deliveries to be purchased in lower-priced supply tier rate; (3) offer an additional level of financial

commitment to MWD; and (4) are not tied to reliability (i.e., supply reliability for all member agencies is the same).

- ***Framework for future water management while avoiding significant cost impacts in the near term.***
The proposed rate structure offers a framework for future water management of imported and local water supplies without creating significant cost impacts to member agencies in the near-term.

Implementation

- The proposed rate structure will be implemented on January 1, 2003.
- The rate structure is a pricing mechanism designed to support a continued collaborative planning effort between MWD and member agencies used to determine MWD's future water supply and infrastructure needs.

DETAILS

General Overview

- Proposed rate structure is consistent with: (1) MWD Board Strategic Plan Policy Principles (adopted in December 1999); and (2) the intent and elements of MWD Board Action Plan for the rate structure (adopted in December 2000).
- Supply reliability is the same for all member agencies, i.e., not tied to contracts.
- Rates and charges unbundled, allowing for choice in services and providing the basis for a wheeling rate.
- Areas with increasing demands on MWD will pay proportionately more for their water through second tier of the water supply rate.
- Member agencies may request Purchase Orders for firm water supplies, offering pricing benefits for member agencies and more financial security for MWD.

Specific Elements

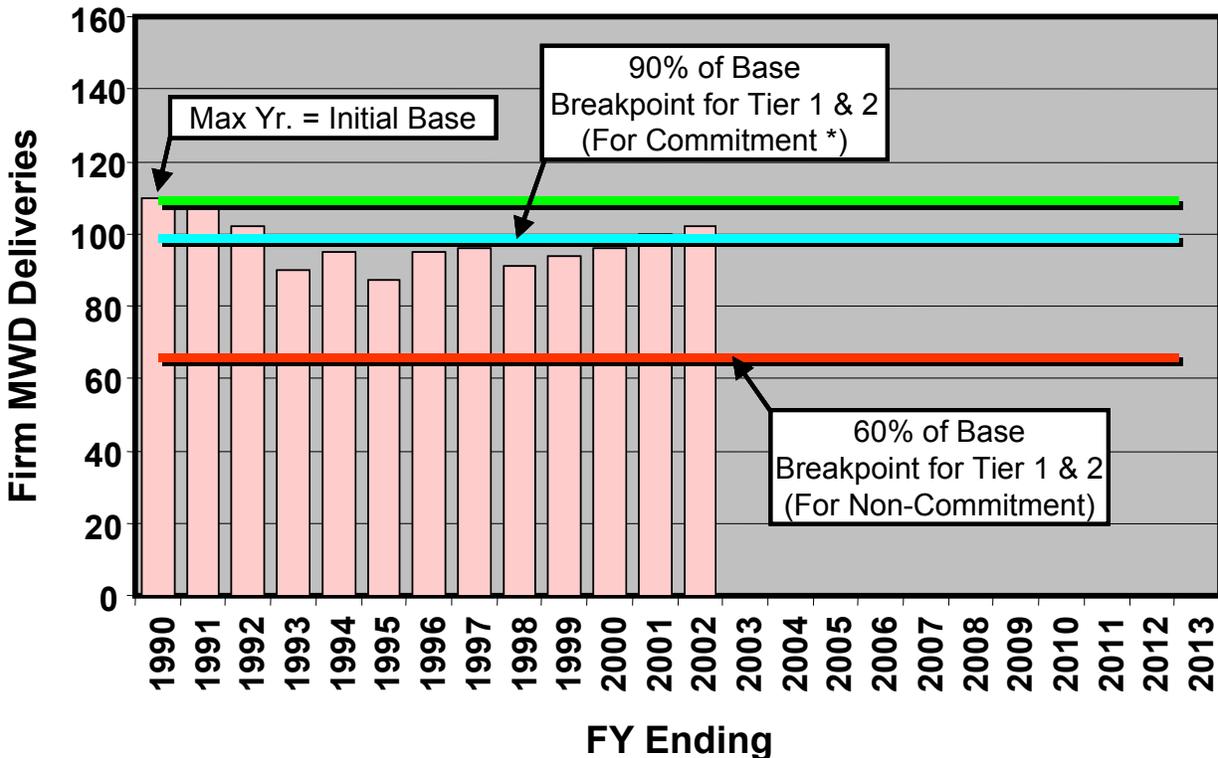
Unbundled Commodity Rates

- A. Current commodity rate for water will be unbundled into five separate commodity rates:
 - Supply Rate – two tiers, and recovers costs associated with water supply (discussed in more detail in following section)
 - System Access Rate – recovers costs associated with system capacity for conveyance and distribution
 - Water Stewardship Rate – is used to help fund local water recycling, groundwater, and conservation programs
 - Power Rate – recovers MWD's melded power cost for pumping SWP and Colorado River supplies
 - Water Treatment Rate – recovers costs for treatment.

Water Supply Rate

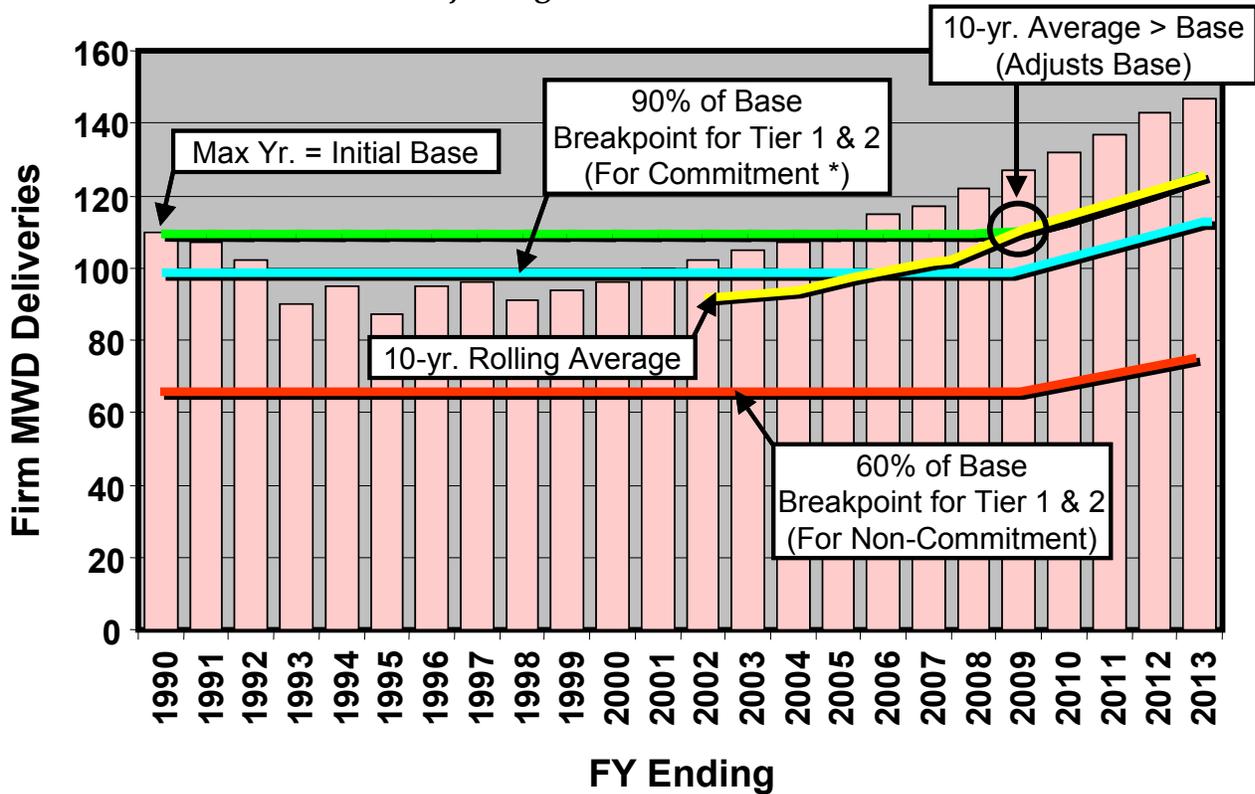
- A. The water supply rate will have two tiers, which reflect MWD’s existing and future costs for acquiring and storing supplies.
- B. Tier 2 rate will be set by MWD’s Board each year, to reflect MWD’s incremental cost of providing water supply to its member agencies. Tier 1 rate will be set to recover remaining supply costs.
- C. Tier 2 rate is currently estimated to be about \$100 to \$125/AF greater than the Tier 1 rate. Tier 2 rate will provide a pricing signal for local water management and water marketing.
- D. A two-tier water supply rate will also address increasing demands placed on MWD.
- E. An initial base (Base) for each member agency is established using that agency’s highest firm water delivery from MWD from FY 1990 to FY 2002 (see Figure 1).
- F. If a member agency chooses not to submit a Purchase Order request, then the Tier 1 rate would apply to firm water deliveries up to 60 percent of the Base, and the Tier 2 rate would apply to firm water deliveries above 60 percent of the Base, on an annual basis (see Figure 1).
- G. If a member agency chooses to submit a Purchase Order request, then that agency agrees to purchase a minimum of 60 percent of its Base times 10, over the ten-year period.
- H. Upon execution of the Purchase Order, the member agency is eligible to purchase up to 90 percent of its Base at the Tier 1 rate, and the Tier 2 rate would apply to firm deliveries above 90 percent of its Base, on an annual basis (see Figure 1).
- I. In the future, the Base will be the greater of a member agency’s historical maximum firm delivery from FY 1990 to FY 2002, or the ten year rolling average of firm deliveries (Figure 2).

**Figure 1.
Two-Tiered Water Supply Rate:
Establishing the Initial Base**



* Member agency agrees to purchase at least 60% of Initial Base times 10, over next ten years.

**Figure 2.
Two-Tiered Water Supply Rate:
Adjusting Base in the Future**



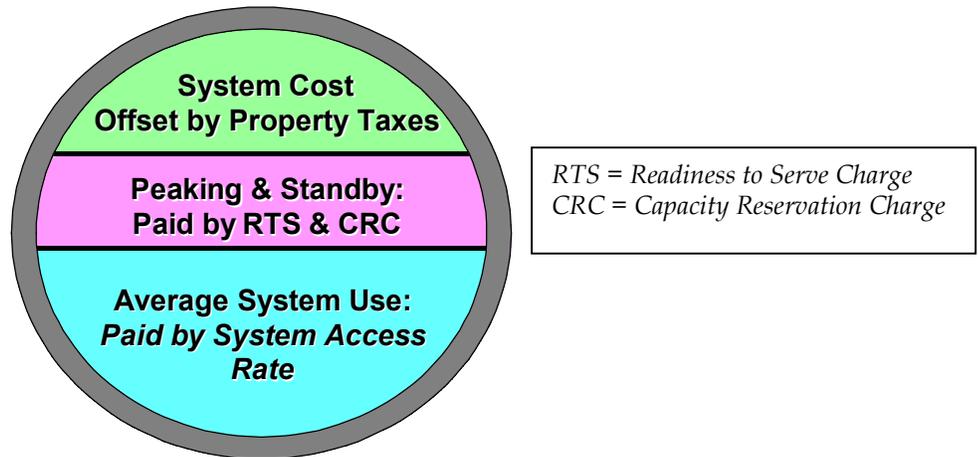
* Member agency agrees to purchase at least 60% of Initial Base times 10, over next ten years.

Fixed Charges

- A. In addition to the commodity rates, member agencies would also pay the following fixed charges:
 - o RTS Charge – covers costs for MWD’s emergency storage and conveyance standby, which is allocated to each member agency based on its 10-year rolling average of firm demands
 - o Capacity Reservation Charge – recovers costs for peak capacity on MWD’s distribution system. Each member agency reserves summer (May through September) peak capacity and pays the charge based on capacity reserved on a cfs basis.
- B. Standby charges, for those member agencies that elect to have MWD continue to assess the MWD Standby charge, will be deducted from member agencies’ allocated RTS charges—as is currently done.
- C. Property taxes will be used to offset capital costs for conveyance on the SWP and MWD’s distribution system—as is currently done.

Figure 3 illustrates how the property taxes, fixed charges, and the System Access Rate will be used to recover costs for conveyance and distribution.

**Figure 3.
MWD System Cost Allocation and Recovery**



Local Storage Replenishment and Agricultural Deliveries

- A. Surplus water supply, when available, can be purchased for long-term local storage replenishment and agricultural deliveries.
- B. The current operating rules for surplus water purchases under the long-term seasonal storage and interim agricultural programs will continue.

Wheeling Services

Wheeling pays the following commodity charges:

- System Access Rate
- Water Stewardship Rate
- Power at actual (not melder) cost
- Water Treatment Rate (if necessary)
- Appropriate member agency costs

Implementation

This rate structure, with the elements described above, will be implemented on January 1, 2003. The rate structure is a pricing mechanism designed to support good water management and continued collaborative planning efforts between MWD and member agencies.

Addressing New Demands

- A. The rate structure addresses the water supply portion of new demands on MWD, by including these costs in the Tier 2 Water Supply Rate.
- B. MWD will utilize year 2005 Urban Water Management Plans from the member agencies and retail providers to identify MWD's new supply and infrastructure needs.
- C. A mechanism to recover costs for MWD's infrastructure associated with increasing system demands will be developed and in place by 2006.

**Subcommittee on Rate Structure Implementation
Responses to Subcommittee Questions**

On September 18, 2001 staff presented the Member Agency Managers' rate structure proposal (Proposal) to the Subcommittee on Rate Structure Implementation (Subcommittee). The Subcommittee had several questions and asked staff, in consultation with the member agency managers, to respond prior to the September 25, 2001 Board workshop on the rate structure.

Question 1: What is the impact of reducing the maximum amount of Tier 1 water that a member agency with a purchase order can buy from 90 percent of its Base down to 80 percent of its Base?

Response: The 90 percent limit on supply purchases at the lower Tier 1 rate was chosen to minimize the initial financial impact and risk to all member agencies resulting from the Proposal and to encourage conservation and investments in local resources. If the limit on the amount of supply that can be purchased at the lower Tier 1 Supply Rate is reduced from 90 percent to 80 percent of a member agency's Base, more member agencies will immediately purchase a greater amount of their supply at the higher Tier 2 Supply Rate. This is particularly true during dry years when member agencies need more supply from the system. Lowering the amount of supply that can be purchased at the lower Tier 1 supply rate from 90 to 80 percent of a member agency's Base will result in substantial impacts during dry years and higher degrees of volatility in the average rate paid by the member agencies. Figure 1 illustrates the difference in the total amount of supply sold at the higher Tier 2 Supply Rate if 80 rather than 90 percent is used to define the amount of supply sold at the lower Tier 1 Supply Rate. The increase in the number of member agencies that would purchase supply at the higher rate is shown in Figure 2.

Figure 1. Total Amount of Supply Purchased At Higher Tier 2 Rate

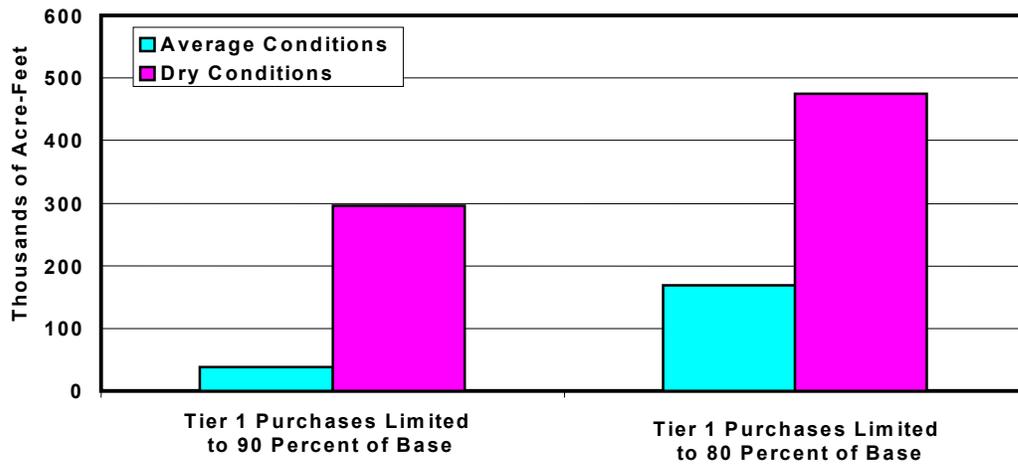
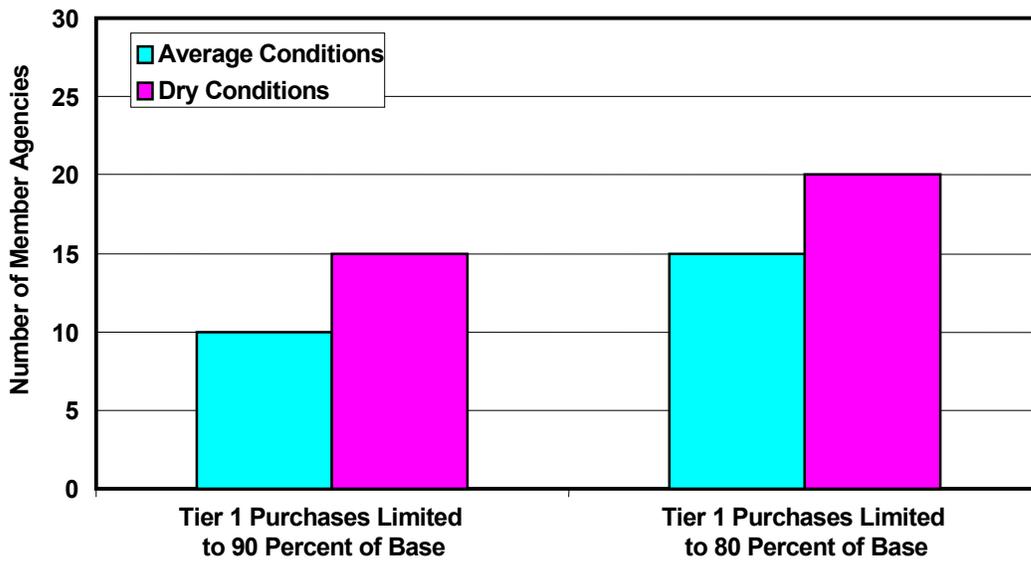


Figure 2. Number of Member Agencies that Purchase Supply At Higher Tier 2 Rate



Question 2: What is the impact of a cap on the differential between the Tier 1 and Tier 2 supply rates?

Response: The purpose of the Tier 2 Supply Rate is to reflect Metropolitan's cost of acquiring additional supply and encourage water conservation and investments in local resources. A cap on the differential between the Tier 1 and Tier 2 Supply Rates may result in a cap on the Tier 2 Supply Rate and potentially distort the price signal and its desired outcomes. However, each year as part of the annual rate setting process, the Board will review the supply conditions and the cost to set the Tier 1 and Tier 2 Supply Rates.

Question 3: Assuming that surplus water is available, how long will the current Long-term Seasonal Storage Service Program and Interim Agricultural Water Program be continued?

Response: The Proposal retains these programs to mitigate the initial financial impacts to the member agencies and their customers due to the change in the Metropolitan rate structure. The Proposal contemplates these programs would remain in place for the next ten years. As is the case today, the Board would set the rates for the Long-term Storage Service Program and Interim Agricultural Water Program.

Question 4: If a member agency increases its use of local supplies and decreases its use of Metropolitan system water, is its Base reduced?

Response: Under the Proposal, a member agency's Base would not be adjusted downward in order to avoid exposure to purchasing additional supplies at the higher rate. If the Base were adjusted downward member agencies that implemented conservation and more efficiently managed local resources would be penalized because they may have to purchase more water at the higher Tier 2 rate in the future.

Question 5: Does a member agency that unexpectedly loses local supply (e.g., groundwater contamination) have to pay the higher Tier 2 supply rate?

Response: A member agency that loses local supply production due to a system outage or a regulatory event may have to purchase supply at the higher Tier 2 rate. Over time, if the member agency is not able to reclaim its local supply and its use of Metropolitan supplies continues to increase, its Base will eventually increase as its ten-year rolling average of firm demand increases. As a result, the member agency would not continue to purchase more supply at the higher Tier 2 rate.

Question 6: How is the SDCWA/IID Transfer accounted for in the Base calculated for the San Diego County Water Authority?

Response: The initial Base used for purposes of determining the annual limit on Tier 1 purchases is defined as the maximum annual purchase since fiscal year 1990 and does not include the SDCWA/IID transfer. Under the Proposal, the calculation of the ten-year rolling average used to reset the Base in the future does not include the SDCWA/IID Transfer because the supply cost for this water would be paid by SDCWA. The SDCWA/IID Transfer is expected to begin in fiscal year 2003 at 20,000 acre-feet and increase by 20,000 acre-feet per year until reaching 200,000 acre-feet in 2012.

Question 7: Should there be a discounted rate (similar to the long-term replenishment rate) for deliveries used for seawater barrier purposes?

Response: Deliveries used for seawater barrier purposes cannot be interrupted during a drought or for any other reason. Metropolitan charges the full service rate for seawater barrier deliveries. Under the Proposal this practice would continue.

Question 8: If a member agency that has used less than its purchase order commitment requests more water from Metropolitan in the final year of the purchase order that Metropolitan cannot supply, is the member agency still obligated to pay for the entire purchase order commitment?

Response: The member agencies are obligated to pay for the entire purchase order commitment.

Question 9: What happens if not all of the supply available to the member agencies at the lower Tier 1 supply rate is purchased in a single year?

Response: The purchase order is a pricing tool only. If all of the supply that may be purchased at the lower Tier 1 rate is not used in a given year then that supply may be sold at the higher Tier 2 supply rate, available as surplus, stored for future use, or lost from the system.

Question 10: Can member agencies pool their purchase orders together or sell their purchase order to another member agency that wants to avoid the higher Tier 2 supply rate?

Response: The purchase order is a pricing tool. It does 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.

Question 11: Can a member agency enter into a purchase order at any time?

Response: Under the Proposal, all member agency purchase orders would extend over the same ten-year period. Member agencies would execute purchase orders so that they would be effective January 1, 2003.

Question 12: What are the rules and formulas used to calculate the rates and charges?

Response: In January 2002, as part of the annual rate cycle and prior to adopting any rates and charges associated with the Proposal, the Board will receive a report on the Proposal. The report will include a detailed cost of service study, which will discuss the cost of service process.

An industry standard embedded cost of service process has been used to identify Metropolitan's revenue requirements by the various service functions (e.g. supply, conveyance, distribution, etc.) and to determine how much cost should be classified as being for peak, average and standby purposes. The classified service function costs are

then allocated to the rate design elements. The following provides a brief description of each of the rate design elements.

- Tier 2 Supply Rate (\$/af) - cost of acquiring additional supply.
- Tier 1 Supply Rate (\$/af)- total supply revenue requirement less Tier 2 supply rate revenues and other revenue offsets, divided by projected Tier 1 deliveries.
- System Access Rate (\$/af) - capital costs incurred to meet average demands and operations maintenance and overhead costs for the conveyance and distribution service functions divided by projected total deliveries.
- System Power Rate (\$/af) - power costs for pumping on the State Water Project and Colorado River Aqueduct divided by the projected Metropolitan deliveries in acre-feet.
- Water Stewardship Rate (\$/af) - Local Resources Program and Conservation Credits Program costs as well as other water management costs as determined by the Board divided by projected total deliveries.
- Treatment Rate (\$/af) - cost of providing treated water service divided by projected treated water deliveries.
- Readiness-to-Serve Charge (RTS) - system emergency storage and conveyance and distribution standby costs not paid by property taxes. The RTS is allocated among the member agencies based on a ten-year rolling average of firm demands.
- Capacity Reservation Charge (CRC) (\$/cfs)- distribution capital costs incurred to meet peak day demands divided by the total amount of capacity requested by the member agencies in cubic feet per second (cfs).

Question 13: Can Metropolitan implement the alternative rate structure in July of 2002?

Response: At the request of many of its member agencies, Metropolitan's rates currently become effective in January of each year. The January effective date provides enough time for the member agencies and their customers that typically budget on a July - June fiscal year basis to set their own rates and charges and prepare their own budgets. Even though the new rates and charges in the Proposal would not be effective until January of 2003, consistent with Metropolitan's current rate cycle, the Board would consider the new rates and charges recommended by the Chief Executive Officer in January of 2002, hold a public hearing on these rates and charges in February and then adopt the rates and charges in March of 2002.

A January effective date provides sufficient time for the member agencies and their customers to deal with implementation issues, including how to pass the Tier 1 and Tier 2 pricing on to their customers.

**Comparison Between Member Agency Managers Rate Structure Proposal
and Metropolitan’s Board Principles
(Prepared by Metropolitan Staff)**

Board Principles	Member Agency Managers Rate Structure Alternative
Strategic Plan Policy Principles (Adopted in December 1999)	
<p>Regional Provider Metropolitan is a regional provider of water for its service area. In this capacity, Metropolitan is the steward of regional infrastructure and the regional planner responsible for drought management and the coordination of supply and facility investments. Regional water services should be provided to meet the needs of the member agencies. Accordingly, the equitable allocation of water supplies during droughts will be based on water needs and adhere to the principles established by the Water Surplus and Drought Management Plan.</p>	<p>Supports the Regional Provider Principle</p> <ul style="list-style-type: none"> Metropolitan, working collaboratively with its member agencies, will secure necessary water supplies and build appropriate infrastructure to meet existing and future needs of its member agencies. There would be no difference in reliability for firm supplies purchased at Tier 1 and Tier 2 rates.
<p>Financial Integrity The Metropolitan Water District Board will take all necessary steps to assure the financial integrity of the agency in all aspects of operations.</p>	<p>Supports the Financial Integrity Principle</p> <ul style="list-style-type: none"> Through voluntary purchase orders, Metropolitan could have an assured level of firm water purchases up to 1.2 mafy (60% of maximum annual firm water sales) over ten years. Through voluntary purchase orders, Metropolitan provides a pricing incentive for member agencies to purchase up to 1.7 mafy of firm water in 2003 (90% of maximum annual firm water sales). <p>Compared to the current rate structure, fixed revenue is estimated to increase.</p>
<p>Local Resources Development Metropolitan supports local resources development in partnership with its member agencies and by providing its member agencies with financial incentives for conservation and local projects.</p>	<p>Supports the Local Resources Development Principle</p> <ul style="list-style-type: none"> Financial incentives for conservation and local projects are provided in two ways: (1) Tier 2 price is set at Metropolitan’s cost of securing new supply and sends a price signal for alternative supply development and (2) water stewardship charge is established to help fund existing and future local water recycling, groundwater, desalination, and conservation programs.

**Comparison Between Member Agency Managers Rate Structure Proposal
and Metropolitan’s Board Principles
(Prepared by Metropolitan Staff)**

Board Principles	Member Agency Managers Rate Structure Alternative
Strategic Plan Policy Principles - Continued	
<p>Imported Water Service Metropolitan is responsible for providing the region with imported water, meeting the committed demands of its member agencies.</p>	<p>Clarifies the Imported Water Service Principle</p> <ul style="list-style-type: none"> Based on collaborative planning with member agencies, Metropolitan would secure and deliver imported water to meet existing and future supply needs.
<p>Choice and Competition Beyond the committed demands, the member agencies may choose the most cost-effective additional supplies from either Metropolitan, local resources development and/or market transfers. These additional supplies can be developed through a collaborative process between Metropolitan and the member agencies, effectively balancing local, imported, and market opportunities with affordability.</p>	<p>Supports the Choice and Competition Principle</p> <ul style="list-style-type: none"> Member agencies may choose the most cost-effective additional supplies from among Metropolitan, local resources development and/or market transfers. In addition, the unbundling of rates and charges allows choice in services.
<p>Responsibility for Water Quality Metropolitan is responsible for advocating source water quality and implementing in-basin water quality for imported supplies provided by Metropolitan to assure full compliance with existing and future primary drinking water standards and to meet the water quality requirements for water recycling and groundwater replenishment.</p>	<p>Supports the Water Quality Principle</p> <ul style="list-style-type: none"> Metropolitan’s responsibilities for source quality and in-basin water quality for imported supplies are unchanged. The cost of source quality is recovered through the tiered supply rates. The cost for in-basin water quality is recovered through the treatment surcharge, which is the same as status quo.

**Comparison Between Member Agency Managers Rate Structure Proposal
and Metropolitan’s Board Principles
(Prepared by Metropolitan Staff)**

Board Principles	Member Agency Managers Rate Structure Alternative
<p>Cost Allocation and Rate Structure The fair allocation of costs and financial commitments for Metropolitan’s current and future investments in supplies and infrastructure may not be reflected in status quo conditions and will be addressed in a revised rate structure:</p> <p>(a) The committed demand, met by Metropolitan’s imported supply and local resources program, has yet to be determined.</p> <p>(b) The framework for a revised rate structure will be established to address allocation of costs, financial commitment, unbundling of services, and fair compensation for services including wheeling, peaking, growth, and others.</p>	<p>Supports the Cost Allocation and Rate Structure Principle</p> <ul style="list-style-type: none"> • Committed demand by member agencies is established by voluntary purchase orders. • The allocation of cost and unbundling of services are based on standard cost-of-service methodology. • The existing full service rate is unbundled into: <ul style="list-style-type: none"> ➢ Tiered supply rates (reflecting Metropolitan’s existing and future costs of supplies), ➢ System access rate (wheeling), ➢ Capacity reservation charge (peaking), ➢ RTS (standby), ➢ Water stewardship rate (local resources management), ➢ System power rate, and ➢ Treatment surcharge.
<p>Steering Committee Guidelines (Approved in January 2000)</p>	
<p>“Needs-Based” Allocation</p> <ul style="list-style-type: none"> • Dry-year allocation should be based on need 	<p>Supports the guideline</p> <ul style="list-style-type: none"> • There would be no difference in reliability for firm supplies purchased at Tier 1 and Tier 2 rates.

**Comparison Between Member Agency Managers Rate Structure Proposal
and Metropolitan’s Board Principles
(Prepared by Metropolitan Staff)**

Board Principles	Member Agency Managers Rate Structure Alternative
<p>No Significant Disadvantage and Fair</p> <ul style="list-style-type: none"> • Rate structure should not place any class of people in the position of significant disadvantage. • Rate Structure should be fair. 	<p>Supports the guidelines</p> <ul style="list-style-type: none"> • Member agencies are treated equally. • All supplies would be allocated during droughts based on the water needs of member agencies. • Financial impacts to the member agencies in year 2003 are estimated to be minimal. The financial impacts henceforth are dependent on the collaborative planning between Metropolitan and member agencies and the ability of member agencies to develop cost-effective alternative supplies and manage peak deliveries.
<p>Simple</p> <ul style="list-style-type: none"> • Rate structure should be reasonably simple and easy to understand. 	<p>Meets the guideline</p> <ul style="list-style-type: none"> • The proposal is easy to understand and is based on uniform rates and charges that recover costs of services.
<p>Metropolitan Revenue Stability</p> <ul style="list-style-type: none"> • Rate structure should be based on stability of Metropolitan’s revenue and coverage of costs. 	<p>Supports the guideline</p> <ul style="list-style-type: none"> • Compared to status quo, fixed revenue is estimated to increase by 50%. Fixed revenues are collected through property taxes, voluntary purchase orders, capacity reservation charge, and readiness-to-serve charge.

THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

RESOLUTION _____

**RESOLUTION OF THE BOARD OF DIRECTORS
OF THE METROPOLITAN WATER DISTRICT OF
SOUTHERN CALIFORNIA
TO APPROVE RATE STRUCTURE PROPOSAL AND TO DIRECT
FURTHER ACTIONS IN CONNECTION THEREWITH**

WHEREAS, the Board of Directors (“Board”) of The Metropolitan Water District of Southern California (“Metropolitan”), pursuant to Sections 133 and 134 of the Metropolitan Water District Act (the “Act”), is authorized to fix such rate or rates for water as will result in revenue which, together with revenue from any water stand-by or availability service charge or assessment, will pay the operating expenses of Metropolitan, provide for repairs and maintenance, provide for payment of the purchase price or other charges for property or services or other rights acquired by Metropolitan, and provide for the payment of the interest and principal of its bonded debt; and

WHEREAS, in July 1998 the Board commenced a strategic planning process to review the management of its assets, revenues and costs in order to determine whether it could conduct its business in a more efficient manner to better serve residents within its service area; and

WHEREAS, after conducting interviews with its directors, member agencies, business and community leaders, legislators and other interested stakeholders, and having public meetings to solicit public input, the Board developed and adopted Strategic Plan Policy Principles on December 14, 1999 (the “Strategic Plan Policy Principles” which document is on file with the Board Secretary) to guide staff and the member agencies in developing a revised rate structure; and

WHEREAS, the Board has received and reviewed several rate structure proposals developed during the strategic planning process and after thorough deliberation adopted a Composite Rate Structure Framework on April 11, 2000 (the “Rate Structure Framework” which document is on file with the Board Secretary); and

WHEREAS, the Board adopted a Rate Structure Action Plan on December 12, 2000 (the “Action Plan” which document is on file with the Board Secretary) and endorsed in concept a detailed rate design proposal (the “December 2000 Proposal” which document is on file with the Board Secretary) developed from the Rate Structure Framework and directed staff to work with

the Board and member agencies to resolve outstanding issues identified during the implementation of this rate design; and

WHEREAS, on September 10, 2001 an alternative Rate Structure Proposal was originally presented to the Board's Subcommittee on Rate Structure Implementation (the "Subcommittee") for its review and consideration; and

WHEREAS, on September 18, 2001 the Subcommittee evaluated and considered the alternative Rate Structure Proposal (see Attachment 1 to Board Letter 9-6, dated the date hereof and hereinafter referred to as the "Proposal"), together with staff analysis of the Proposal and other information and comments received from member agencies; and

WHEREAS, on September 25, 2001, the Proposal, together with a staff review thereof, was further discussed and considered by the Board of Directors; and

WHEREAS, each of said meetings of the Board were conducted in accordance with the Brown Act (commencing at 54950 of the Government Code), at which due notice was provided and quorums were present and acting throughout; and

WHEREAS, the Proposal is consistent with the Board's Strategic Plan Policy Principles, supports efficient water resources management, encourages water conservation and facilitates a water transfer market;

NOW, THEREFORE, the Board of Directors of The Metropolitan Water District of Southern California does hereby resolve, determine and order as follows:

1. The Board finds that the Proposal is consistent with the Board's Strategic Plan Policy Principles, addresses the issues raised during the consideration of the December 2000 Proposal, furthers Metropolitan's strategic objectives to ensure the region's long term water supply reliability, supports and encourages sound and efficient water resources management, supports and encourages water conservation, facilitates a water transfer market and enhances the fiscal stability of Metropolitan.

2. The Board hereby directs the Chief Executive Officer, in consultation with the General Counsel, to take all actions necessary in order to further implement the Proposal in accordance with the terms set forth in this Resolution.

3. The Board approves the Proposal and directs the Chief Executive Officer, in consultation with the General Counsel, to (i) prepare a report on the Proposal describing each of the rates and charges and the supporting cost of service process and (ii) utilize the Proposal as the basis for determining Metropolitan's revenue requirements and recommending rates to become effective January 1, 2003, in Metropolitan's annual rate-setting procedure pursuant to Section 4304 of the Administrative Code. Under the procedure set forth under Section 4304, a public hearing on the rates and charges implementing the Proposal shall be held at the February

2002 Board meeting (or such other date as the Board shall determine) and the Board will take final action to adopt the rates and charges in March of 2002 (or such other date as the Board shall determine).

4. The Chief Executive Officer, the Chief Financial Officer and the General Counsel are hereby authorized to do all things necessary and desirable to accomplish the purposes of this Resolution, including, without limitation, the commencement or defense of litigation.

5. This Board finds that approval of the Proposal as provided in this Resolution is not defined as a Project under the California Environmental Quality Act (CEQA), because the proposed action involves the creation of government funding mechanisms or other government fiscal activities which do not involve commitment to any specific project which may result in a potentially significant physical impact on the environment (Section 15378(b)(4) of the CEQA Guidelines).

6. If any provision of this is held invalid, that invalidity shall not affect other provisions of this Resolution which can be given effect without the invalid portion or application, and to that end the provisions of this Resolution are severable.

I HEREBY CERTIFY, that the foregoing is a full, true and correct copy of a Resolution adopted by the Board of Directors of The Metropolitan Water District of Southern California, at its meeting held on October 16, 2001.

Executive Secretary
The Metropolitan Water District
of Southern California