



San Diego County Water Authority Lawsuit Against Metropolitan Water District *January 2012*

Board Action:

SUPPORT

Rationale:

The San Diego region is heavily dependent upon the delivery of water from the Metropolitan Water District, and thus costs of local water districts are subject to the rates set by policy makers in the north. The lawsuit being pursued by the San Diego County Water Authority challenges those rates as a means to limit the rate increases that ratepayers have come to expect each year. While a final decision may not be expected for some time, the challenge is a necessary step to provide ratepayers relief that could total \$1.3 to \$2.1 billion over the next 45 years. Despite the outcome of this lawsuit, the County Water Authority, as well as other agencies, must limit labor cost increases as an additional means to reduce rate increases into the future.

Background

On June 10, 2010, the San Diego County Water Authority (CWA) Board of Directors voted unanimously to file a lawsuit challenging the Metropolitan Water District (MWD) water rates for 2011 and 2012. The lawsuit contends MWD improperly overcharges for transporting water through its facilities, and uses those funds to subsidize the cost of water it sells to its 26 member agencies.

Currently MWD has several categories of rates it charges for the services it provides. Among these rate categories are “supply”¹ and “transportation”². Table 1 below is a brief description of the rates that are being contested.

Table 1: Description of CWA Contested Rates

Rate	Description of Rate	CWA Complaint
System Access Rate	Paid by MWD member agencies that buy MWD water or use MWD’s facilities to transport water not purchased from MWD.	Nearly 80% of MWD's State Water Project water supply costs are assigned to this water transportation rate category, in violation of California law. These costs belong in the Water Supply Rate category.

¹ The “supply” rate pays for the cost of water supplies MWD acquires.

² The “transportation” rate is a combination of three rates (System Access, System Power, and Water Stewardship) MWD charges any party that uses MWD’s pipelines and other facilities to transport non-MWD water.

<p>System Power Rate</p>	<p>Recovers the costs of energy needed to pump water to Southern California. It is a charge applied to every acre-foot of water transported by MWD.</p>	<p>The rate currently includes Department of Water Resources' energy costs for the State Water Project, which MWD does not own or operate. The costs of power needed by the state to deliver water supply to MWD's connections in Southern California are a supplier cost and part of the cost of that water supply. However, MWD improperly assigns that cost to its own transportation rate category. These costs belong in the Water Supply Rate category.</p>
<p>Water Stewardship Rate</p>	<p>Recovers the cost of providing financial incentives to MWD's member agencies for developing new local water supply projects. These incentives can be for conservation, recycled water, desalination, or other new water supplies.</p>	<p>MWD charges these water supply costs as a water transportation services. Because this rate pays for water supply development, it should be applied to the Water Supply Rate.</p>
<p>Water Supply Rate</p>	<p>Rate recovers the cost of MWD's water supplies including supplies it imports from the Colorado River, State Water Project supplies, and money it spends to support the development of new local water supplies and water conservation.</p>	<p>All of these water supply costs belong in the Water Supply Rate category.</p>

MWD is CWA's largest water supplier. In 2010, CWA purchased 342,000 acre-feet of water from MWD, which amounts to about 50 percent of San Diego's water supplies.³ Also, CWA is the single largest user of MWD transportation services. CWA uses MWD facilities to transport water from the Colorado River, which it purchases under water conservation agreements with the Imperial Irrigation District and from the lining portions of the All American and Coachella Canals.

MWD's Rates

According to an independent study conducted by Bartle Wells Associates, MWD deviates from the American Water Works Association's *Principles of Water Rates, Fees and Charges* with regard to the following: accounting of operation and maintenance expenses, allocation of costs of service to cost components, distribution of costs to customer classes, and design of wholesale water rates.

In particular, MWD's rate methodology is inconsistent with how MWD's water system actually functions. MWD purchases water under a contract with the Department of Water Resources and the water supply is delivered to MWD's facilities in Southern California. Water is also obtained from the Colorado River Aqueduct, via MWD's facilities.

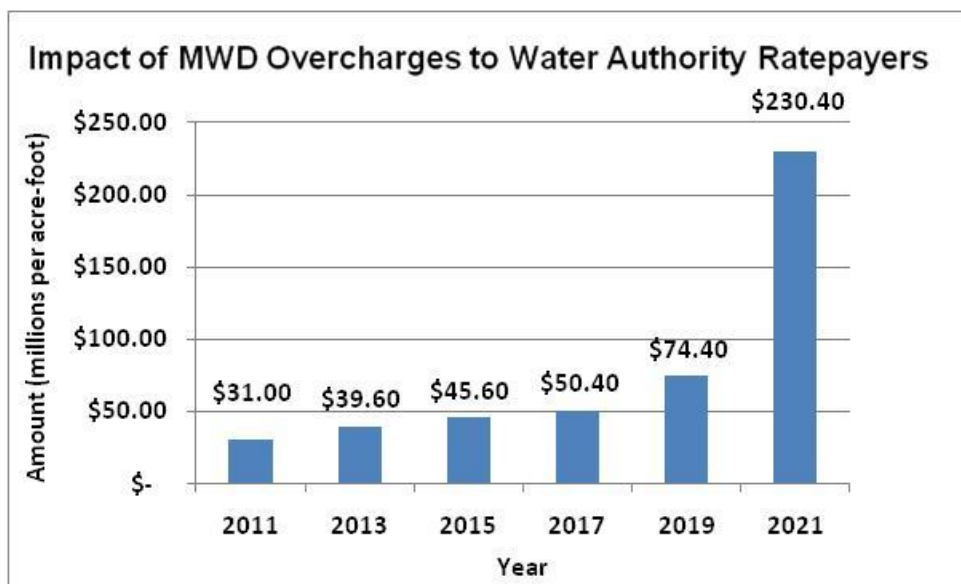
³ CWA News Release "Water Authority Board Approves Filing a Lawsuit against Metropolitan Water District Challenging Illegal Water Rates" 2010.

CWA receives transportation of water that is not owned or purchased by MWD across MWD’s system within Southern California. However, CWA is required to pay a price for the service that is calculated on the basis of the cost of capital facilities, operations, maintenance and power, along with other expenses paid to the Department of Water Resources under a water supply contract for the imported water supply, which is used by others.⁴ Essentially, MWD charges CWA transportation costs based on an inter-regional water supply, when in fact the CWA transportations occur only on an intra-regional level.

Furthermore, MWD recovers most of its costs of obtaining water supply via the State Water Project by rates that are not charged exclusively in connection with obtaining MWD’s water supplies. Rather, these costs are allocated by MWD’s conveyance and aqueduct service function and recovered through rates imposed for the use of MWD’s conveyance system.⁵

Financial Impact

MWD’s current rate structure forces CWA and its ratepayers to pay more than MWD’s actual and proportionate cost for the water transportation services MWD offers to San Diego. According to CWA, MWD will overcharge CWA’s ratepayers approximately \$31 million in 2011.⁶ CWA estimates the long-term impact of ratepayers to be \$1.3 to \$2.1 billion over the next 45 years.⁷ The following graph



demonstrates that the ratepayers will pay a disproportionately high price for Colorado River water transfer supplies transported to San Diego. The costs are based on annual water sales of 600,000 acre-feet and a \$40 billion cost to fix the Bay-Delta.⁸

Local Impact

The Water Stewardship rate must be applied as a supply function rate

because it recovers the costs associated with provision of subsidies for local supply projects and conservation programs; there is no relation to MWD’s transportation facilities. As a result of this misallocation, MWD is undercharging for supply services and overcharging for other MWD services.⁹ The MWD may deter water conservation as a result of the cost of water being under priced. Furthermore, development of local water supply resources may be hindered because the relative cost of imported water and locally developed supplies is distorted, which causes the local projects to appear to be less cost-effective.

⁴ Bartle Wells Associates “Metropolitan Water District of Southern California Water Rates” 2010, pp.4.

⁵ Colantuono & Levin, PC “Proposed Water Rates to be Effective January 1, 2011” April 2010, pp4.

⁶ Estimation provided by CWA, “Frequently Asked Questions: MWD Water Rate Challenge”.

⁷ CWA presentation to SDCTA Board of Directors. November 18, 2011.

⁸ Graph taken from the CWA, “MWD Water Rate Challenge: Water Authority Takes Action to Protect Ratepayers”.

⁹ Bartle Wells Associates

Litigation Status

The case has been assigned to San Francisco Superior Court Judge Richard A. Kramer, and has been designated as “complex”. It is estimated a trial court decision will be made by mid-2012. The Imperial Irrigation District and the Utilities Consumer’s Action Network (UCAN) are also litigants on the side of CWA. Two claims by CWA, breach of fiduciary duty and breach of good faith, were struck down by Judge Kramer at a January 4, 2012 hearing. CWA’s new claims that will remain in the case include causes of action related to MWD’s breach of its contract to follow applicable law in charging the Water Authority and its ratepayers for transportation of water, MWD’s unlawful under calculation of the Water Authority’s Preferential Right to purchase water and MWD’s imposition of a retaliatory contract provision designed to prevent the Water Authority from challenging MWD’s unlawful rates.

At the January 6, 2012 hearing, Judge Kramer allowed for discovery in the case, which MWD had opposed. The judge also denied without prejudice MWD’s motion to bifurcate the case, saying he will consider how the case should be tried after the parties complete discovery. Judge Kramer asked the parties to work with a special master to develop and implement a plan for discovery. A further case management conference was set for February 17, 2012.