APPROVED
By the Board of Directors of
The Metropolitan Water District
of Southern California
at its meeting held

JUL - 9 1996

41982

8-1

MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

EXECUTIVE SECRETARY

June 25, 1996

To: Board of Directors (Water Planning and Resources Committee--Action)
(Executive Committee--Action)
(Finance and Insurance Committee--Information)

From: General Manager

Submitted by: Debra C. Man, Chief
Planning and Resources Division

Subject: Transmittal of the Rate Refinement Recommendations

RECOMMENDATIONS

It is recommended that the Board of Directors:

(1) approve the rate and revenue actions developed during the Rate Refinement Process as policy guidance for setting rates and charges over the next five years (described in detail in Attachment 1),

(2) suspend collection of the New Demand Charge imposed for fiscal year 1995-96 and fiscal year 1996-97 pursuant to Resoulution 8469 and Resolution 8493 respectively, pending the further actions with respect to the New Demand Charge described in Attachment 1,

~~(2)~~(3) direct staff and the Rate Refinement Team to enter into Phase 2 of the Rate Refinement process to develop analyses to assist the Board in deliberations on wheeling, the San Diego County Water Authority Water Exchange Proposal, and opportunities to reduce water costs. These analyses are to be completed by mid-September, 1996, ~~and~~

~~(3)~~(4) direct staff and the Rate Refinement Team to complete Phase 3 discussions, regarding the development of alternative revenues, long-term rate structure reforms, completion of a Drought Management Plan, and addressing outstanding issues from prior phases, and

(5) find that the actions pursuant to recommendations (1) through (4) above are exempt from the California Environmental Quality Act (CEQA) under Public Resources Code Section 21080(b)(8) because they involve refinement of rates and other charges which are for the purposes of (a) meeting operating expenses, (b) purchasing or leasing supplies, equipment or materials, (c) meeting financial reserve needs and requirements, and (d) obtaining funds for capital

projects necessary to maintain service within existing service areas; and, additionally, because they involve refinement of government funding mechanisms which do not involve commitment to any specific project which may result in a potentially significant physical impact on the environment or which will be used to fund projects which have CEQA documentation in place prior to construction of any facility or facilities.

EXECUTIVE SUMMARY

The Rate Refinement Process (RRP) was initiated in January 1996 to resolve issues of financing the resources and facility strategies of the approved Integrated Resources Plan. In particular, the negotiators addressed the difficulties in determining equitable future Readiness-to-Serve (RTS) and New Demand Charges (NDC) for individual agencies, the increasing cost of water supplies, and the impact of lower than expected demands. The Rate Refinement negotiations have occurred over the past five months and have involved over 120 hours of discussions.

Metropolitan and its member agencies agreed to work through a facilitated process to develop refinements that would help reduce complexity and increase certainty regarding the cost of Metropolitan's service. The process involved all member agencies, who were represented in the discussions by negotiators from Metropolitan, the San Diego County Water Authority, Western Municipal Water District, Municipal Water District of Orange County, Calleguas Municipal Water District, Central and West Basin Municipal Water Districts, the cities of Fullerton, Long Beach, Los Angeles, Santa Monica, and Foothill Municipal Water District. Some member agency participants also had the responsibility of representing the interests of other member agencies in their geographic area. In addition, the Chairman of the Board appointed a Board Task Force to provide policy guidance to the process and facilitate communication with the Board. James Waldo of Gordon, Thomas, Honeywell served as the facilitator for Phase 1 of the process.

The goal of the Rate Refinement Team was to develop a set of recommendations for consideration by the Metropolitan Board that would improve the existing rate structure. This first set of RRP Recommendations is detailed in Attachment 1--"Report on Rate Refinement Recommendations". The Report on Rate Refinement Recommendations has been signed and endorsed by all of the negotiators.

These recommendations represent a significant improvement to the status quo in two important ways. First, they eliminate the current, unintended incentives for member agencies to seek water supplies from sources other than Metropolitan. Second, they stabilize and simplify the current rate structure and water management programs for five years.

In order to achieve these benefits, the Rate Refinement Team recommends that Metropolitan adopt the recommendations included in Attachment 1 as guidelines for setting rates and charges over the next five years.

These recommendations would affect the following areas:

- Rate Management Objectives and Overall Rate Levels (Attachment 1, pages 4-5)
- Readiness-to-Serve Charge (Attachment 1, pages 5-6)
- New Demand Charge (Attachment 1, pages 6-7)
- Peaking (Attachment 1, page 7)
- Agricultural Water Rate (Attachment 1, pages 7-8)
- Treatment Surcharge (Attachment 1, page 8)
- Short- and Long-Term Water Storage Programs (Attachment 1, pages 8-11)
- Connection Maintenance Charge (Attachment 1, page 11)

It was also recommended that the RRP continue in two more phases. Phase 2 would result in the development of analyses to assist the Board in its deliberations regarding wheeling, technical evaluation of the San Diego County Water Authority Water Exchange Proposal, and opportunities to reduce water costs, and is expected to be completed in September 1996. Phase 3 addresses the development of alternative revenues, long-term rate structures, and completion of a Drought Management Plan, and would be finished by March 1997.

It was further recommended that the Board find that the above actions are exempt from CEQA under Public Resources Code Section 21080(b)(8) because they involve refinement of rates and other charges which are for the purposes of (a) meeting operating expenses, (b) purchasing or leasing supplies, equipment or materials, (c) meeting financial reserve needs and requirements, and (d) obtaining funds for capital projects necessary to maintain service within existing service area; and, additionally, because they involve refinement of government funding mechanisms which do not involve commitment to any specific project which may result in a potentially significant physical impact on the environment or which will be used to fund projects which have CEQA documentation in place prior to construction of any facility or facilities.

DETAILED REPORT

Please see Attachment 1--"Report on Rate Refinement Recommendations".

CM:arb

Attachment

cmrrr696/board

Attachment No. 1

Report on Rate Refinement Recommendations

May 23, 1996

Introduction

The Rate Refinement Process ("RRP") began in January, 1996 to address some immediate concerns of member agencies and MWD management about MWD's current rate structure. Generally, these concerns relate to the difficulties in determining future Readiness to Serve and New Demand charges for individual agencies, the increasing costs of water supplies, and the impacts of lower-than-expected demands. The discussion led to larger issues concerning the correlation between the Capital Improvement Plan ("CIP") and the financial security of MWD in the longer term.

Accordingly, this first report from the RRP participants to the Board includes in Section I a set of recommendations on immediate or short-term refinements to MWD's rate structure and water management programs, and describes in Section II the work RRP participants will undertake during the remainder of 1996 on broader issues relating to long-term rate reform, potential CIP cost savings, and potential alternative revenue sources for MWD, as well as other MWD policies.

The RRP involves all member agencies, who are represented in the discussions by negotiators from MWD, San Diego County Water Authority, Western Municipal Water District, Municipal Water District of Orange County, Calleguas Municipal Water District, Central and West Basin Municipal Water Districts, the cities of Fullerton, Long Beach, Los Angeles, Santa Monica, and Foothill Municipal Water District. Some agency representatives in turn bear responsibility to keep other agencies in their geographic area informed of the RRP's activities and progress. In addition, the MWD Board established a Task Force to provide policy guidance and oversight of the process, and to facilitate communications between the process and the Board.

Jim Waldo of the Gordon Thomas Honeywell law firm in Tacoma/Seattle is facilitating the RRP. Mr. Waldo is the mediator who facilitated the recent *Monterey Agreement* among contractors in the State Water Project.

The recommendations in Section I of this report represent a significant improvement to the status quo in two important ways:

1. they eliminate the current, unintended incentives for member agencies to seek water supplies from sources other than MWD; and

2. they also stabilize and simplify the current rate structure and water management programs for five years. This provides a foundation or *"five-year bridge"* for development of, and transition to, reformed rate structures and water management programs in the longer term, which will be one of the subjects of the RRP's work for the remainder of this year. (See recommendations for Phases Two and Three in Section II, at page 13, below.)

Background

When the Board approved the new rate structure in 1993, it was generally designed to help reverse an historic imbalance between MWD's fixed costs and revenues; *i.e.*, MWD's costs were mostly fixed but it was largely dependent on variable revenues from water sales. The imbalance had begun to pose a fiscal problem only in recent years because MWD had begun incurring additional fixed costs for new capital improvements to help meet its goals for water supply, quality and service reliability. These system improvements will require dependable revenue streams to maintain MWD's strong financial position.

MWD's Integrated Resources Plan ("IRP") was intended to identify an effective mix of regional water resources, and to guide the development of a rate structure that was carefully balanced with CIP investments. The rate structure devised, however, has had some unintended and potentially dire consequences.

The combination of declining water sales and increasing capital costs is the principal cause of upward pressure on rates. Higher rates and other features of the rate structure (discussed below) provide a significant incentive for member agencies to intensify recent efforts at obtaining water supplies from sources other than MWD.

Hence, the fundamental ingredients for a rate spiral are present. The situation has striking parallels in the electric utility industry, where increasing competition among suppliers has spawned utility restructuring, and a spate of mergers and acquisitions. The electric utility industry is hurtling toward open markets and customer choice, causing concerns along the way about how to pay for investments in generation and transmission

facilities that potentially become stranded as customer bases become fluid and transient.

The desire of MWD and member agencies to avoid the potential consequences of a similar circumstance in part prompted initiation of the RRP.

Rate Parameters

The first, and one of the most significant, products of the RRP to date is the development of nine Rate Parameters. These parameters describe the characteristics of an equitable rate structure.

1. A rate structure should provide certainty and durability. A rate structure should be in place for an extended period of time.

2. Beneficiaries should pay equitably for capacity, availability of service and commodity.

3. Rates should generate sufficient regional income to meet all necessary costs with a combination of fixed and variable revenues, and to provide for MWD financial security. These regional costs should be balanced with local water system needs so that the magnitude and timing of MWD rate increases do not tend to crowd out local investments that may also be critical to regional reliability.

4. Rates should be understandable at all levels. Rate system uncertainties should not drive customers off MWD's system or prevent local investments.

5. Rates should provide choices for member agencies relating to benefits and costs, and encourage member agency decisions that lead to certainty and willingness to pay for a level of service.

6. Rates should encourage prudent water management practices, investments and best strategic choices for MWD and member agencies, but the rate system should not be used to address all issues. MWD should maintain its commitment to conservation, reclamation, storage and other programs, but it should remove policy issues from the rate structure unless rates are essential to the policy. Contracts should be used for variable needs above base rate structure (*e.g.*, for conservation, storage, etc.).

7. Growth should pay a fair share of new investments required to meet associated water needs. Growth charges should be flexible

and should not distort water supply choices. Growth charges should be integrated with future annexation fees.

8. Rates should provide MWD and member agencies the opportunity to customize local revenue packages. MWD's rate structure should be designed to allow members/retailers to reshape MWD charges in local rates/charges. The rate structure should reduce dependency on MWD members, and extend the revenue base to other sources.

9. Construction of new regional facilities in MWD's service area should not occur until member agencies demonstrate their willingness to pay for a level of service that includes the facility.

Section I: ***First Set of Recommendations for Short-term Refinements of MWD's Rate Structure and Water Management Programs***

The structure and application of both the Readiness to Serve ("RTS") charge and the New Demand Charge ("NDC") raise several concerns. The RTS was generally intended to be a fixed charge covering principal and interest on capital debt for reliability that is not secured by taxes. This would help reduce MWD's dependence on variable revenues, and provide a specific funding source for additional capital expenditures. The NDC was intended to help ensure that new growth paid its fair share of the costs to meet its demands. Participants in the RRP hold little confidence, however, that either will serve its intended purpose.

1. **Rate Management Objectives.** Overall rates and the increase in the cost of MWD supplies are a concern for all RRP participants. Accordingly, RRP participants recommend that the Board adopt the following rate management objectives:

Recommendation:

a. that the RTS and water rates for 1997 be implemented as approved by the Board;

b. that the RTS should increase by $8 million per year over the next four years beginning in January, 1998 (as shown in the schedule, below);

c. that the treated water rate not increase by more than 1.5% for each of the two calendar years beginning in 1998 and increase no more than 2% in the following two years; and

d. that in no case will the increase in MWD's effective rate be greater than 3% in any year for the next five years.

2. Readiness to Serve Charge. Because each agency's proportionate share of the RTS is based on an average of its historical annual purchases of water from MWD, an agency can reduce its RTS obligation by simply reducing its water purchases at a rate faster than other agencies reduce theirs. This is known as "roll-off." Rolling off can cause cost-shifting among member agencies. When agencies with access to alternative water supplies roll-off the MWD system, the RTS obligations of agencies remaining on the system can increase. Today, Agencies can roll-off up to 50% of their base.

Volatility of the RTS rate is inherent because it is calculated as a rolling average of annual water purchases. Changing hydrology causes wide variance in agencies' annual water purchase levels. As a specific example, because long-term storage water is included in the RTS base only in the year used (not the year purchased), there is uncertainty in its price due to changes in the total amount of RTS collections and in agencies' proportionate shares.

The difficulty and complexity in calculating the RTS also can make it more difficult for an agency to evaluate the benefits of seasonal storage programs, thus making them less attractive.

In short, an agency's RTS obligation can be a complex calculation, and can depend largely on the unpredictable actions of other agencies.

The complexity, uncertainty and roll-off provision of the RTS in combination represent a strong incentive for member agencies to seek alternative water supplies.

Recommendation:

a. The following RTS schedule should fix the RTS for the next five calendar years beginning in 1997, and member agencies should be able to rely on this schedule for five years. During the next five years, the MWD Board should take action to further revise the RTS or to establish other charges that assure adequate fixed revenues. Nothing in this recommendation is intended to predetermine either the level or features of a long-term rate structure. A long-term rate

structure, if developed before the expiration of the five-year period, should give member agencies the option to convert to the new rate structure before the expiration of the five-year period, at each agency's discretion.

b. The RTS component of the current rate structure should be fixed at the following levels for the next five calendar years:

January '97 $72 million;

January '98 $80 million;

January '99 $88 million;

January '00 $96 million;

January '01 $104 million.

c. Each member agency's RTS share should be based on the three-year period ending June 30, 1996, utilizing the same method that was used to calculate RTS shares, except that cooperative storage purchases paid for in FY 95-96 should be excluded from the calculation.

d. The standby charge should be retained for agencies that wish to use it to pay for all or a portion of an agency's RTS obligation.

3. **New Demand Charge.** Growth should pay its fair share of costs associated with meeting its new demand. The current NDC mechanism does not accomplish this goal. A new mechanism to ensure growth pays its fair share is needed.

The NDC does not require an up-front commitment from member agencies to pay for new facilities necessary to meet new demand. Instead, the obligation to pay the NDC arises only when an agency's water purchases exceed a calculated threshold based on historical annual average purchases. Participants in the RRP have identified at least two fundamental problems with this approach.

First, the NDC is another incentive to become less dependent on MWD water, and to obtain water for growth from an alternative source even if excess capacity is available in MWD's system.

Second, there may be too great a spread between the 50% RTS roll-off floor and the threshold for the NDC, allowing most

agencies ample latitude to meet existing and new demands without incurring the NDC.

MWD thus finds itself in the position of planning and constructing new facilities to meet anticipated demand with the expectation that growing areas in the future will pay the NDC. Growing agencies, however, have a greater incentive to avoid purchasing MWD water. This produces the unintended consequence that existing ratepayers could have a greater financial burden than they would have if the NDC was not in place.

Recommendation:

a. Collection of the current NDC should be suspended until an area-wide new development-based fee structure is implemented by MWD, or until normal system demands exceed 2.2 MAF/yr., whichever occurs first.

b. In those member agencies where connection fees have been established to pay for new growth, and where the agency chooses to continue collection of the charge, MWD should work with such agencies to afford them the continuing ability to collect the fees.

c. If it becomes necessary to reinstitute the NDC because a suitable alternative has not been developed, growth in member agency demand which occurred during the suspension period will not be retroactively subject to the NDC and the nexus between growth and the related cost of service would be re-established.

4. Peaking. At current levels of demand, peaking on the MWD system does not require facility improvements.

Recommendation:

a. If peaking on MWD's system becomes a long-term problem, MWD should establish new charges for collection of revenues to pay for the costs associated with peaking.

5. Agricultural Water Rates. The RRP participants recognize and support the efforts of the Ad Hoc Committee on Agricultural Water Policy to develop a long-term agricultural water policy. To help assure consistency between the efforts of the Committee and the RRP, the following recommendations are offered to the Committee for its consideration.

Recommendation:

a. During the next five years, MWD should retain the current interim agricultural rate structure, or something substantially similar to it.

b. Within five years, MWD should enter into contracts or other arrangements with member agencies for Ag water that provide incentives reflecting the benefits of this program to MWD, and that are consistent with the then-existing rate structure.

c. MWD should pursue opportunities for Ag to receive full reliability in exchange for paying full price for water.

6. Treatment Surcharge.

Recommendation:

a. MWD should retain the treatment surcharge at its current level pending review by, and recommendations to the Board from, MWD and member agencies about the proposed Ozone Retrofit program and the water treatment costs in the O & M budget.

b. MWD should adjust the surcharge in the future only as decisions are made regarding regulatory timing, capacity sizing and construction of treatment facility improvements.

c. Water quality costs that benefit nontreated water users, such as sanitary surveys, should be shared equally.

7. Short- and Long-term Water Storage Programs. RRP participants have developed a process to transition MWD's water management programs to a new structure for the future that will more effectively achieve regional goals, and will provide more certainty for member agencies.

Recommendation:

a. Current Short-term Seasonal Storage Program

i. Beginning in October, 1997, MWD should provide a five-year transition period from the current incentive level to a future incentive level. Seasonal *"shift"* storage incentives should be ramped down annually in equal increments from the current level to $85/AF incentive for treated water, and $60/AF incentive for untreated water. RRP participants intend that this transition neither cause local projects to become economically

disadvantaged, nor *"strand"* investment in local projects, nor create an opportunity to receive an economic windfall.

ii. MWD should consider a local project to be disadvantaged, or investment in it to be *"stranded,"* by the transition from the current to the future incentive level only if it meets the following definition:

(1) A local seasonal storage project (or that portion of a local project under consideration as a stranded investment) that was designed to take advantage of an MWD program, and

(2) that would not have been initiated had the MWD program not been in place, and

(3) that would not be financially viable without the continuation of the MWD program, and

(4) for which a construction contract was let prior to December 1996.

iii. Compliance with the definition of disadvantaged or stranded project should not be exceedingly difficult. Standard investment evaluation methodologies should be used whenever possible.

iv. Agencies should have three options for transitioning to the new incentive level for seasonal storage programs:

(1) operate their seasonal storage programs in compliance with the annual ramp-down of the incentive over the five-year period;

(2) for existing programs, enter into a five-year contract with MWD ending in May, 2001, for $140/AF incentive for treated water and $115/AF incentive for untreated water (such contracts should provide MWD benefits from assured seasonal shifts); or

(3) for existing programs, enter into a long-term contract with MWD that allows recovery of its undepreciated sunk fixed costs associated with the change in incentive levels, then provides for managing the agency's program going forward from that point at the new, lower incentive level.

b. Future Short-term Seasonal Storage Program

i. Short-term Seasonal storage water price incentives should reflect the benefit received by MWD.

ii. The short-term seasonal storage water rate incentive program may change from year to year. Member agencies should make investments with the knowledge that rate incentives may change.

iii. If a short-term seasonal storage program will provide long-term benefits to MWD, but requires a long-term incentive rate, then the member agency and MWD should consider using a contract or other formal arrangement for the project.

iv. MWD should send a notice immediately to member agencies and their subagencies that revisions to the current seasonal storage program are pending.

v. RRP participants will consider in Phase Three of the RRP, and make recommendations about, how seasonal storage water should be integrated into any long-term rate reforms.

c. Interruptible Long-term Storage and Replenishment Programs

i. The water rate for non-firm deliveries should be equal to the firm water rate, less the benefits associated with this program to MWD.

ii. For the next five years, existing program parameters, including the current incentives, are adequate to manage water supplies within the existing MWD delivery system. Over the long term, however, water supplies and delivery constraints will require MWD to make better use of available storage facilities when supplies are available.

iii. In the long term, a basin-by-basin approach should be used to better coordinate deliveries and withdrawals so that storage program objectives are accomplished.

iv. Within the next two years, MWD should define and quantify its regional objectives for use of groundwater basins and surface storage reservoirs. It should also determine appropriate economic incentives to accomplish these objectives.

v. Within five years, all participation in MWD long-term storage programs should occur by contract or other formal arrangements between MWD and individual member agencies.

vi. MWD should develop prototype or pilot programs to determine the best means of coordinating use of groundwater basin and surface storage reservoirs to meet regional objectives.

8. Connection Maintenance Charge ("CMC"). This charge is intended to recover a portion of the costs of operating and maintaining service connections.

Recommendation:.

a. MWD should retain the current CMC at the current level.

b. RRP participants will give further consideration in Phase Three of the RRP to whether this charge ought to correspond more directly with the full and true costs of operation and maintenance of connections.

9. Cost Containment and Linkage With Rates. Generally, RRP participants are concerned there is a *"disconnect"* between MWD's cost structure, including the Capital Improvement Plan ("CIP"), and the rate structure. In addition, the frequency, timing and size of MWD rate increases necessary to recover its costs can tend to crowd out local investments, and can influence other local resource decisions of regional significance.

In basic terms, the CIP is based on an IRP that is designed to ensure reliability of supply and service for current and future dry-year demands. The rate structure, however, is based on actual water purchases. This establishes a dynamic in which agencies that are primarily dependent on MWD and agencies that incur the NDC can bear an inequitable proportion of the fixed costs of the new improvements. Agencies that can roll-off or that can stay under the NDC threshold can receive the reliability benefits of the improvements to meet their peak demands, but they may not pay an equitable share of the fixed costs.

This potential problem was first identified in the 1994 Final Report of the MWD Blue Ribbon Task Force. As recommended in that Final Report, and as recognized by participants in the RRP, the challenge is to devise a rate structure that more closely links the CIP with member agencies' commitment to pay for service. This will help

avoid *"overbuilding"* the MWD system, and help ensure more equitable allocation of the costs of capital improvements among member agencies.

The RRP participants' current approach to this problem involves three elements:

1. RRP participants are considering alternative rate structures wherein CIP investment decisions are based on member agencies' commitments to pay for a level of service that meets IRP goals for water supply, quality and reliability of service ("Minimum Purchase Commitment Program"). This would require an ongoing and iterative IRP/CIP process in which reliability and service goals, and capital investment decisions to meet them, are continually re-evaluated with the involvement of member agencies.

2. RRP participants are reviewing MWD's cost structure, especially the CIP, to identify potential savings and recommend some approaches to cost containment.

3. RRP participants are considering potential sources of new revenue for MWD that would help ease dependence on water sales to member agencies, and would more equitably recover the costs of MWD's system from all beneficiaries in the region.

Recommendation:

a. RRP participants should continue their consideration of MWD's costs, including the CIP, to identify potential savings and to make recommendations to the Board about approaches to cost containment, and potential rate structure reforms.

b. RRP participants should continue their consideration in Phases Two and Three of the RRP of potential alternative revenue sources for MWD, and make recommendations to the Board.

c. Future recommendations about alternative revenues, changes to the rate structure, and cost containment should be coordinated with Phase One Recommendations about rates and water management programs for the five-year bridge period.

SECTION II: Additional RRP Work

The above recommendations conclude Phase One. If adopted by the Board, the participants will have met their initial goals to simplify and stabilize the current rate structure and water management programs for five years.

The participants believe that the adoption of their Phase One recommendations will provide the necessary time and solid foundation to address the remaining issues requiring resolution. Accordingly, the participants recommend two more phases of work during the next year.

Phase Two

Phase Two work would be accomplished between July and mid-September. This phase would focus on three areas: cost containment, the San Diego proposal, and wheeling issues.

1. Cost Containment. The RRP participants will discuss further recommendations regarding cost containment through:

   a. the member agency managers' annual retreat, which will focus on this issue, and

   b. the RRP participants will then determine if any further recommendations should be made on major capital decisions including the Ozone Retrofit program and Inland Feeder, for consideration by the MWD Board.

2. San Diego Proposal. To aid the MWD Board in its deliberations, the RRP participants will evaluate the potential benefits, and economic and operational impacts of the San Diego proposal. In addition, and as desired by the MWD Board, the participants will assist in developing options and a recommendation for consideration by the MWD Board.

3. Wheeling Policy. The RRP participants will prepare an evaluation of intra- and inter-MWD service area wheeling issues. In addition, the participants will work on developing options and a recommendation for consideration by the MWD Board.

Phase Three

During Phase Three, to be undertaken from October, 1996, through March, 1997, the RRP participants recommend consideration of several critical issues. These issues include:

1. Long-term Rate Structure Reforms. Implementation of the Phase One recommendations, particularly refinements to the implementation of the RTS and NDC, will help promote greater financial stability for MWD. However, the RRP participants believe that additional actions may be required to assure long-term financial stability for MWD. During Phase One, the RRP participants discussed such approaches as "Minimum Purchase Commitments" under which member agencies would enter into contracts committing to purchase specified amounts of water from MWD in the future. It was determined that such an approach constitutes such a major modification in policy that additional time would be required to develop long-term recommendations for consideration by the MWD Board. During Phase Three, the RRP participants recommend a detailed analysis of Minimum Purchase Commitments and other alternative approaches that would provide assurances of adequate revenues to pay for the large fixed cost commitments required by the implementation of the IRP, thereby enhancing financial security for MWD.

2. Alternative Sources of Revenue. The RRP participants recommend that MWD explore additional sources of revenue other than from the rates and charges paid by member agencies. Many entities other than water users obtain significant economic benefits from the existence of infrastructure created by MWD and the reliability of service it makes possible, but are not required to pay amounts commensurate with the benefit received. During Phase Three, it is recommended that the RRP identify possible sources of additional revenue and develop implementation strategies.

3. Drought Management Plan. The RRP participants recommend completion of a Drought Management Plan for the region to be implemented in the event that MWD is unable to fully meet the demands of its member agencies.

4. Follow-up on Earlier Phases. Finally, it is recommended that Phase Three include follow-up on issues related to discussions under Phase One. These issues include: (1) the integration of the short-term seasonal storage program and long-term groundwater storage programs into the long-term rate structure and (2) consideration of whether the connection maintenance charge accurately reflects all costs associated with the operation and maintenance of connections to the MWD system.

Relationship Between Phase One and Phases Two and Three

The RRP participants believe that the recommendations emerging from Phase One will improve the current MWD rate structure. These changes will promote certainty and create incentives for resource management that are more consistent with achieving the goals of the IRP. However, beyond the implementation of the Phase One recommendations, the RRP participants recognize the importance of resolving the outstanding issues that are to be addressed in Phases Two and Three. Accordingly, pending direction from the MWD Board, the RRP participants are committed to a schedule that would provide evaluations and recommendations on some issues by mid-September 1996, and on all outstanding issues by March 30, 1997.

The perspectives of the member agencies on the overall success of the RRP will, of course, depend upon the resolution of issues in all three identified phases. The RRP participants recommend that implementation of the Phase One recommendations proceed. However, some RRP participants strongly believe that these changes alone will not be sufficient to provide adequate reliability, financial stability and equity in the future. Even with the implementation of the Phase One recommendations, some member agencies may be critical of the overall process, if the critical issues reserved for consideration in Phases Two and Three are not resolved in the near future.

The above recommendations are completed for submission to the Board of Directors of the Metropolitan Water District on May 23, 1996, by the Rate Refinement Participants.

Western Municipal Water District
(Riverside Caucus)

City of Los Angeles

Municipal Water District of Orange County
(Orange County Caucus)

Central Basin Municipal Water District
West Basin Municipal Water District
(Central Basin Caucus)

Calleguas Municipal Water District
(Northern Caucus)

Metropolitan Water District of Southern California

City of Santa Monica
(Los Angeles County Cities)

City of Long Beach
(Los Angeles County Cities)

City of Fullerton
(Orange County Caucus)

San Diego County Water Authority

Foothill Municipal Water District
(Northern Caucus)

The above recommendations are completed for submission to the Board of Directors of the Metropolitan Water District on May 23, 1996, by the Rate Refinement Participants.

Western Municipal Water District
(Riverside Caucus)

City of Santa Monica
(Los Angeles County Cities)

City of Los Angeles

City of Long Beach
(Los Angeles County Cities)

Municipal Water District of Orange County
(Orange County Caucus)

City of Fullerton
(Orange County Caucus)

Central Basin Municipal Water District
West Basin Municipal Water District
(Central Basin Caucus)

San Diego County Water Authority

Calleguas Municipal Water District
(Northern Caucus)

Foothill Municipal Water District
(Northern Caucus)

Metropolitan Water District of Southern California