



February 15, 2012

Attention: Administrative and Finance Committee

Policy Recommendation Regarding Disbursement of Potential Proceeds Resulting from Metropolitan Water District Rate Litigation. (Action)

Staff recommendation

Adopt a policy approving the allocation and distribution to Water Authority Member Agencies of any net refund proceeds—less legal expenses incurred by the Water Authority—resulting from the outcome of the MWD rate litigation, with the funds being distributed to each member agency based upon its proportional share of M&I Melded Supply water deliveries for each year during the period of the litigation.

Alternatives

1. As an alternative to issuing direct refunds, the Board could direct the Water Authority to credit member agencies these same amounts toward future water purchases.
2. As an alternative to refunds, the Water Authority Board could direct the funds to be used for allowable Water Authority purposes.

Fiscal impact

The litigation with MWD over illegal overcharges will not likely be resolved for several years. Assuming the Water Authority prevails in the litigation, MWD will be required to refund the disputed payments, which are being held in escrow, to the Water Authority. The approximate balance in the escrow account as of the end of Calendar Year 2011, and representative distributions to member agencies are shown in the Attachment, Table 2. Actual amounts would vary depending on the outcome of the lawsuit, the escrow balance at that time, the legal costs associated with the litigation, and actual member agency water deliveries during that period.

Background

The Water Authority is suing MWD to stop illegal water rate overcharges and its retaliatory business practices that target and discriminate against the Water Authority and its ratepayers. The lawsuit, filed in 2010, asserts that MWD overcharges the Water Authority for transporting water through MWD facilities, and uses that money to subsidize the cost of water MWD sells to its member agencies. The Water Authority also alleges that MWD violated the terms of the 2003 Exchange Agreement between MWD and the Water Authority where MWD agreed to charge lawful rates to the Water Authority for transportation. Two additional claims challenge MWD's calculations of the Water Authority's Preferential Rights to MWD water and ask the judge to throw out a punitive contract clause, called "rate structure integrity" that MWD developed in an attempt to prevent the Water Authority from challenging its rates in court or before the California Legislature.

Discussion

By law, MWD is required to charge rates that reflect its actual, reasonable, and proportionate costs of serving each class of its customers. The Water Authority's lawsuit claims that MWD is improperly charging tens of millions of dollars annually in water supply costs to its System Access Rate, System Power Rate and Water Stewardship Rate, which comprise MWD's transportation charge. A determination made by Water Authority-retained independent legal and public finance experts agreed that MWD is improperly classifying millions of dollars in water supply costs as transportation costs. The current rate structure forces the Water Authority ratepayers to pay an artificially and disproportionately high cost to transport the Water Authority's independent Colorado River supplies through MWD's facilities. As the only MWD member agency that has invested in its own imported water supplies that require use of MWD's facilities for transportation, MWD's practice creates a subsidy for the other 25 MWD member agencies for water they purchase from MWD.

Under MWD's existing improper rate structure, MWD overcharged the Water Authority's ratepayers on transportation by approximately \$38 million in calendar 2011. This amount is estimated to increase an additional \$40 million in 2012. If the litigation continues, the overcharge would grow by an additional \$57 million, \$54 million, and \$57 million in 2013, 2014 and 2015, respectively (Attachment, Table 1). The overcharges could increase to as much as \$217 million annually by the time the Water Authority's Colorado River supply deliveries are fully implemented in 2021. Under the Exchange Agreement, MWD is required to set aside the disputed amount in a separate escrow account pending outcome of the litigation. If the Water Authority is successful, the escrowed funds would be returned to the Water Authority.

The Water Authority Board has several options for the disposition of these proceeds. Similar to the way in which it treated refunds from MWD in 2001, the Water Authority could distribute the funds directly to member agencies. Alternatively, it could issue credits to offset member agencies' future water bills. In addition to either a distribution or credit to member agencies, the board could elect to use all or a portion of the funds to increase the balance in the Rate Stabilization Fund to offset future rate increases, to make a deposit to the PAYGO fund for capital projects, to redeem outstanding debt, or for any other lawful purpose.

Staff recommends that the Water Authority Board adopt the policy to distribute the net refund proceeds— less legal expenses incurred by the Water Authority —to member agencies in proportion to each agency's share of M&I Melded Supply water deliveries for each year during the period of the litigation. This distribution approach would return the funds equitably to the water agencies that bore the cost of the overcharges, while keeping the Water Authority whole in terms of its legal expenses. Attachment Table 2 contains an estimate of refunded amounts due to each member agency for Calendar Year 2011.

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Attachments

Summary of Estimated MWD Overcharges by Calendar Year
Estimated Water Authority Member Agency Refunds

Table 1
Summary of Estimated MWD Overcharges by Calendar Year

Calendar Year	Estimated MWD Overcharges
2011	\$38 million
2012	\$40 million
2013	\$57 million
2014	\$54 million
2015	\$57 million
Total	\$246 million

Table 2
Estimated Water Authority Member Agency Refunds (CY 2011)

Member Agency	Percent of M&I Melded Supply Deliveries	Estimated Refund
Carlsbad	4.13	\$ 1,569,400
Del Mar	0.28	106,400
Escondido	2.94	1,117,200
Fallbrook	2.04	775,200
Helix	4.92	1,869,600
Lakeside	0.89	338,200
National City	1.25	475,000
Oceanside	5.76	2,188,800
Olivenhain	4.85	1,843,000
Otay	7.75	2,945,000
Padre Dam	2.78	1,056,400
Pendleton	0.01	3,800
Poway	2.64	1,003,200
Rainbow	3.07	1,166,600
Ramona	1.23	467,400
Rincon	1.46	554,800
San Diego	41.08	15,610,400
San Dieguito	0.62	235,600
Santa Fe	1.27	482,600
South Bay	1.79	680,200
Vallecitos	3.84	1,459,200
Valley Center	2.41	915,800
Vista	2.99	1,136,200
Yuima *	0.00	0
Total	100.00	\$ 38,000,000

Note: the numbers in this table do not include a deduction for legal expenses.

*No Melded Supply water deliveries during CY 2011