

# Item 7a

## Cost-of-Service Review

### Timeline

Business and Finance Committee  
June 8, 2009  
Office of the CFO

# April 2009 Board Action: Review Cost of Service

- Board directives included:
  - Consider need to add/delete COS categories
  - Consider increasing fixed charges
    - RTS and Capacity Charges
    - Potential Treated Water Capacity Charge
  - Evaluate opportunities to increase property taxes to cover larger portion of State Water Project costs
  - 2011 rate proposal must recover full COS

# Time Is Of The Essence

- Work through process with member agency managers and Long Range Finance Plan Workgroup
- Monthly reports to Business & Finance Committee
- Initially use evaluation criteria developed in 2008 as part of rate structure review process
- Policy changes would need to be adopted by October/November 2009 to be incorporated in 2011 rate proposal

# Current Rate Structure and Cost of Service Approach

- Adopted by Board in October 2001 and implemented for rates effective 2003
- Member agency proposal consistent with the Rate Structure Action Plan adopted by the Board in December 2000
- Addressed specific Board concerns:
  - Use of property taxes
  - Financial impacts
  - Relative burden of financial risk
  - Financial commitment
  - Water resource management

# Objectives of the 2001 Member Agency Proposal

- **Objective 1:** Maintain MWD as the regional provider of imported water
  - MWD and member agencies work collaboratively to secure necessary water supplies and build appropriate infrastructure
- **Objective 2:** Support cost-effective local resources development and water conservation
- **Objective 3:** Accommodate a water market
  - Unbundle water rates
  - Postage stamp rate concept

# The Current Revenue Structure Was Defined In The 2001 Proposal

- Property Taxes
- Unbundled water rates by service components:
  - Supply (with two tiers)
  - System Access
  - Water Stewardship
  - System Power
  - Treatment
  - Met Objectives 2 and 3
- Two fixed charges: RTS and Capacity Charge
- Cost-of-service methodology was adopted as part of the process

# Additional Elements In The 2001 Proposal

- Voluntary Purchase Order requests for firm water deliveries
  - Defined initial Tier 1 purchase limits
- Water as available for long-term storage replenishment and agricultural deliveries

# Current Rate Setting Process Adheres To The 2001 Board-Adopted Policies

- Determine revenue requirements
- Prepare a cost-of-service (COS) study
- Develop rates and charges
- Approach consistent with industry guidelines
  - Improved nexus between costs and prices

# The Cost-of-Service Process

- Develop Revenue Requirement
  - Cash needs approach
- Place costs into eight service functions:
  - Supply, Conveyance, Distribution, Storage, Treatment, Demand Management, A&G, Hydroelectric
- Classify costs as Demand, Commodity, and Standby
- Allocate costs to rate elements
  - Supply, System Access, System Power, Water Stewardship, and Treatment rates
  - RTS and Capacity Charge

# Cost-of-Service Is Foundation of Rate Design

- Once costs are broken into functions and classifications, then rates can be designed to recover those costs appropriately
- Different ways to collect costs – for example:
  - One volumetric rate to recover all costs
  - A combination of fixed charges and volume based rates to recover the costs of different service functions and behavior types

# Potential Evaluation Criteria

- Revenue stability
- Rate equity and price signal
- Encourages local stewardship
- Consistent with Metropolitan's role as regional provider
- Public understanding
- Other considerations
  - Ease of update
  - Administrative burden
  - Local agency choice

# Cost-of-Service Review Timeline

- Monthly reports to Business & Finance Committee
- June 2009: review of current COS methodology
- July 2009: Member agency input on current methodology
  - Compile potential changes to COS methodology
- August/September 2009: Review with expert panel and develop recommendations
- October 2009: Board considers any alternative COS policies

# Cost-of-Service Review Timeline

(cont'd)

- November/December 2009: Staff develops 2011 revenue requirements
- January 2010: Board considers 2011 revenue requirements
- January 2010: General Manager recommends rates and charges for 2011 and budget for 2010/11
- March 2010: Board considers 2011 rates

# Next Steps

- Schedule Long-Range Finance Plan Workgroup meetings
- Work with LRFP Workgroup and committee to develop composition of expert panel
- Monthly updates to Business & Finance Committee throughout process
  - July update: Review of current COS using 2009/10 study