

Independent Rates Oversight Committee – IROC
August 9, 2010
MINUTES

1. Roll Call

Chairperson Peugh brought the meeting to order at 10:00 a.m. Monica Musaraca called the roll and a quorum was declared. Attendance is reflected below:

Member	Present	Absent
Jim Peugh, Chair	X	
Don Billings	X	
Tony Collins	X	
Christopher Dull		X
Andy Hollingworth	X	
Jack Kubota	X	
Irene Stallard-Rodriguez	X	
Todd Webster	X	
Gail Welch	X	
ExOfficios		
Scott Tulloch, Metro JPA		X
Augie Caires, Metro JPA, <i>Alternate</i>	X	
Ken Williams, City 10		X
Yen Tu, City 10, <i>Alternate</i>		X

2. Non-Agenda Public Comment

There were no non-agenda public comments.

3. Approval of Minutes from 7/19/2010

Chairperson Peugh asked for a motion to approve the Minutes of July 19, 2010, Ms. Sasaki stated a correction of changing the word “litigation” to “mitigation” on page two of the distributed Draft Minutes. Committee Member Billings moved, with one abstention (Welch), all others in favor, the minutes were approved with said correction.

4. Chair Updates – Chairperson Peugh

- Metropolitan Water District will be holding a session tomorrow at 9:00 a.m. if anyone is interested in attending.

5. City Staff Updates , Ann Sasaki, Assistant Director

- August 1, 2010 received final Permit for the Pt. Loma Wastewater Treatment Plant.
- Council on recess for month of August, no NR&C updates today.
- Upcoming Council items for September:
 - Taking Bid-to-Goal Program forward to Rules Committee
 - Pass-through to NR&C
 - Fortistar Expansion (Energy contract to expand Miramar Cogeneration facility to provide power to the Marines)
 - Leadership Development Program

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Chairperson Peugh asked in regard to a spill that occurred on August 4. Ms. Sasaki stated the spill was related to roots, and did reach public waters. Dog Beach was posted for 2 days, however, the spill did not reach the beach. She mentioned there was also a spill this morning into Chollas Creek related to roots as well. She added we will be looking at ways to get news to the public as well as plumbers, when working on their own laterals, to notify the City in advance.

6. **Presentation from San Diego County Water Authority regarding key terms and conditions of a potential Water Purchase Agreement with Poseidon Resources for desalinated seawater from the Carlsbad Desalination Project**

Bob Yamada, Water Resources Manager - San Diego County Water Authority (Water Authority), began his presentation by giving an overview of the Carlsbad Desalination Project (Project). He stated it is a 50 mgd project being developed by Poseidon Resources, using existing intake and discharge structures at the power plant and producing 56,000 AF annually of new highly reliable water supply, which is about 8-9% of our regional water demand. He added the Project is included in the 2005 Urban Water Management Plan, evaluated, certified, and fully permitted. He indicated the Project will initially utilize power plant cooling water as a source of water supply and will later cease to move on to a stand-alone operation. At which time upgrades would be made to the intake to the best available technology.

He referred to his provided documents and described the major permit conditions and environmental mitigation including primary impacts, greenhouse gas mitigation (net greenhouse gas emissions over and above what would already be present by importing water into the region) and Marine Life Mitigation. Marine Life Mitigation is based on stand-alone operation. He noted the Coastal Commission required 66 acres of wetlands restoration as part of the Marine Life Mitigation Plan. The Regional Board will require modifications to intake when Power Plant discharges of seawater are less than Poseidon's intake needs or Power Plant ceases operations. However, any modification to intake requires compliance with CEQA and new Coastal Development Permit.

Referring to slides, he showed and described aerial views. Committee Member Billings asked if there are any capacity issues at the delivery point? Mr. Yamada stated no there are not, in fact the water will go north to the Twin Oaks Valley Water Treatment Plant and will be blended with other water in the clear wells and then proceed south.

He then gave a brief Project background and structure. He stated Poseidon is the developer and owner of the Project, which will be a design/build Contract, which IDE Technologies is the selected process designer, an Israeli based business since 1965. They specialize in the development, engineering, production and operation of advanced desalination solutions, and have recently constructed two of the largest SWRO plants in the world.

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He stated the financing would be approximately 82.5% debt and 17.5% equity. The debt would be issued as tax exempt private activity bonds, they are available due to the economic slow-down. He then described the purpose of the Term Sheet, and what the Board approved on July 22. This sheet will serve as the basis of negotiating a water purchase Agreement. It is non-binding, but identifies key terms and conditions, and allows Poseidon to identify one or more equity investors.

He then described the Basic Terms that were approved by the Water Authority Board. The Water Authority would be the purchaser of water at a contractually defined price, and stated Poseidon takes all Project risks. He said the Water Authority will have an option to own the pipeline after a period of time of satisfactory operation, and the option (not obligation) to purchase the plant beginning in the 11th year of operation. At the end of the 30 year Contract, the purchase price would be \$1.

Mr. Yamada concluded by referring to charts describing maximum price with no MWD incentives, and potential impact on Water Authority M&I treated rates. With the negotiation and approval process, Poseidon must fulfill certain conditions before negotiations for the Water Purchase Agreement begin, Water Authority would complete due diligence, financial, technical, and legal. The Board will then have consideration of the final agreement approval. He then asked for questions.

Committee Member Billings asked in regard to the risk to rate payers, if Poseidon does not operate efficiently, for example. Mr. Yamada stated there are many requirements for Poseidon to produce on a quarterly basis, and if not, there are penalties accrued, as well one of the focuses in the negotiations were to insure there are protections and performance requirements spelled out. Committee Member Billings asked who is responsible for repayment of the debt and pricing risks? Mr. Yamada indicated the financials are not his expertise, but would be able to get the information if needed. Mr. Yamada reiterated the Water Authority is solely the purchaser of the water, and does not have the risks.

Committee Member Hollingworth stated there has been testimony by the MWD CFO, the price of water is influenced by the amount they sell. If the Water Authority reduces their purchases by 8%, would the price of water be raised to compensate? Mr. Yamada indicated the impact on MWD sales from the Project is included in MWD's projections going forward.

Chairperson Peugh asked if the cost of this water would be distributed uniformly, or will the increased cost be only for the Agencies that buy treated water? Mr. Yamada stated the cost will be factored into the Water Authority's melded supply rate. The untreated customers will not pay for the treatment aspect of it, and will receive an adjustment. He added Agencies may choose to build their own local supplies at any time, and that the Water Authority has programs to assist them.

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As far as purchasing water from the Water Authority, member agencies would pay for the cost of the water from the Project as they would pay the cost for imported water from MWD as well as other costs.

Chairperson asked in regard to the costs including re-permitting, when the power plant closes, if sand filtering is the best available technology, would pumping costs rise? And how does this price protection now, take into account after the power plant closes? Mr. Yamada stated the costs include approximately \$20 million to upgrade the intake at the power plant. The project already has a pre-treatment system which includes a dual media filtration system ahead of the reverse osmosis. The focus on the work will be to upgrade the intake structure. The specifics of this upgrade are not yet determined.

Committee Member Welch asked what the operational costs would be particularly the cost of electricity and how this could impact the cost of the water. Mr. Yamada stated Poseidon has a contract with SDG&E for a purchase agreement. It is part of our due diligence to look into all back up material. He noted there would not be onsite generation, it will all be purchased. Committee Member Welch asked if the current requirement of getting 20% and in 2020 33% of their electricity is from renewable resources? Mr. Yamada stated this is being looked into and will be factored into the analysis, but do not have this information now. He is not certain, but there could be a portion of solar energy on site as well.

Committee Member Kubota asked about the plumbing for this amount of water. Mr. Yamada explained that from an operational and flow acceptance point of view, it has to go to the regional system, which will bring it into the aqueducts where there is demand for this throughout the entire year. Committee Member Kubota asked if Poseidon will be the operator of this pipeline, including permitting and licensing? Mr. Yamada stated Poseidon would be responsible until Water Authority purchased the pipeline, where the Water Authority would be owner, operator and maintainer of the pipeline.

Ex-Officio Member Caires asked in regard to due diligence, who is brought on board for this? Mr. Yamada stated a transactional lawyer is on board, as well as consultant expertise from R.W. Beck who was very involved with the Tampa Bay Project, as well as a financial advisor who is very experienced with this type of transaction. He added this team is very capable and talented. Mr. Caires asked what the determining factor in whether or not MWD will provide the subsidy to this project? Mr. Yamada mentioned the lawsuit between CWA and MWD; one of the implications of the lawsuit is the agreement that CWA would have with MWD for funding under MWD's Seawater Desalination Program Agreement that would provide up to \$250 AF of funding for this project is at risk. There is language in the Agreement which states if CWA challenges legally the MET rate structure, MWD can terminate that Agreement. This issue will be considered at the next MWD Board meeting.

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Chairperson Peugh asked if at that point, would the CWA reconsider their decision on whether or not to move forward with this Agreement? Mr. Yamada stated it will be a factor, but the change of rates, in this case, is reflected in the provided graph in the packet, there is not a huge impact. Ultimately, the Board, including the City-10 will vote at that point. He added the region has a lot at stake in this Project.

Committee Member Webster asked in regard to the Twin Oaks Treatment Plant on treated water, would the water coming from the Desal Plant be completely treated going to the clear well? Mr. Yamada indicated the water will be fully treated when leaving the Desal Plant. However, they are looking at the potential to add additional chloramines if necessary before the water moves into the clear well. This will be factored in, and is not yet determined.

Committee Member Billings asked if IROC can be updated as the process proceeds. Mr. Yamada stated there are requirements in the Term Sheet that the Project be under construction by January 1, 2012. The goal would be to move forward over the next several months. The next milestone would be to hold scheduled workshops, which will be in advance of the CWA Board's consideration of any agreement.

Committee Member Hollingworth asked Chairperson Peugh whether it would be appropriate for IROC to advise the Mayor and Council on the Project, and Mr. Peugh indicated it would be. He then asked what would be the appropriate way to provide this advice and he suggested a letter to the Mayor and Council. Mr. Yamada noted the earliest you would see a water purchase Agreement before the CWA Board would be the 4th Thursday in October.

7. **Bid-to-Goal Program (B2G) Status Update: Water Fund Program Implementation and Amendment to the Wastewater Fund Memorandum of Understanding**

Tom Crane thanked the IROC for agreeing to have this briefing, and for supporting the new MOU's going forward and added the schedule is to go to the Rules Committee on September 8, and full Council soon after. In Alex Ruiz' absence, Mr. Crane gave the update and overview of this item.

He referred to his provided handouts and stated the actions requested by the Rules Committee are to approve the new Public Contract Operations Agreement (MOU) for Water Fund employees for FY10-FY14; and approve the Amended Public Contract Operations Agreement (MOU) for Wastewater Fund Employees effective FY10.

Mr. Crane indicated this briefing will be presented to the Rules Committee. He then listed the B2G Program history from FY97 to the current year. The program status was mentioned, which he pointed out Water Operations Division, as well the Water Customer Support Division, has completed their final year of a 5-year

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contract on June 20, 2009, and for FY2010-2014 are part of the Water Fund B2G Program. Wastewater Fund (MWWD) is currently in year 4 of 5-year contract, and for FY10 planned Amendments to match Water proposal. He then reminded the IROC, and described in detail, the components of the B2G Program, referring to his handouts.

He pointed out the Employee Efficiency Incentive Reserve (EEIR) uses are recommended by the LMC and approved by the Department Director. He added the Annual Performance Report (Report) contains divisional performance narratives summarizing key performance measures, goal achievement metrics and financial performance. The results are reviewed by the Finance Deputy Director and Internal Controls section prior to audit by an external 3rd party auditor. He reminded the IROC that no transfer of savings to the EEIR is made and no incentive awards are distributed prior to completion and resolution of the external audit. Also, no disbursement may be made until completion of the external 3rd party audit.

Mr. Crane stated a final B2G Program Report will be instituted, which had not been done in the past. This Report will be posted on websites, distributed to staff and made known to the public as well. He then recapped the features of the 2010 Program Overhaul. He reiterated Program costs are paid for out of savings, and the LMP Bids adjusted downward in the amount of prior year incentive awards, which are built upon prior years and continuously improved. There is also a Policy & Procedures Manual which will guide us through the administration of this Program.

Committee Member Billings asked what happens if the goal cannot be met, and Chairperson Peugh asked if there were quantified measures of effectiveness in the Contract? Mr. Crane stated there are statements of work that should be accomplished. Ms. Sasaki added there are Key Performance Measures that must be met. If you miss 3 of them, savings is decremented by 10%.

Mr. Crane spoke about the Gainsharing Goal Improvements which the Office of the City Auditor Performance Audit found to be more specific, and include more robust information on the relevance and justification, making them more measureable than goals in the previous two years. He then reiterated the goals and benefits of the B2G Program. He concluded by stating we continue the B2G Program for several reasons, some included are to save money, participative employee culture demonstrates ownership and pride in the accomplishments, the Program assists in achieving reduced routine operational costs while improving service and it is good for the ratepayers as well as the employees. He then opened for questions.

Committee Member Hollingworth mentioned to Chairperson Peugh that he supports this, and hopes IROC can guide the Mayor and Council on this Program. Mr. Crane indicated IROC supported the Program in the June meeting and came

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here today to refresh the IROC's knowledge of the Program. And urges IROC to offer their position on this program, if called upon by the Rules Committee or City Council.

8. Proposition 218 Noticing of the effects of the San Diego County Water Authority Pass-through Rate Increases

Committee Member Hollingworth stated this item along with Item 9 could be heard together, as they go hand in hand.

Marsi Steirer introduced Chris Ojeda, Supervising Economist. They provided revised full size copies of the Notice of Public Hearing and noted it was an updated version from the Notice sent out last year. The new information added was the "Water Rates Rolled back in September" section located at the bottom of pages 2 and 3. She indicated the timeline associated with this notice is as follows: NR&C on September 8, then to full Council on September 21. Once agreed to, we will proceed with the mail-out on September 26 with the hearing on November 15. She then opened for questions.

Committee Member Webster asked in regard to the fees for commodity and base, is that including the IPR increase? Chris Ojeda stated the current fees as stated in the notice will be in effect as of date of receiving the notice. The rollback for IPR is scheduled for September 1, so when received it will be current rates.

Committee Member Hollingworth stated he has had problems with the Pass-through Rate Increases, as he abstained last year on this topic. He indicated he feels many parts are not justified. He then added he would like to vote NO on Item 8, with the understanding that if a rate increase is tied to reform specifically with a detailed audit at the Metropolitan Water District's (MWD) cost structure and the way they set rates, it could turn to a YES vote. He added this vote could be co-joined to Item 9 below.

Ms. Steirer indicated she appreciates that, and added we are hoping there will be more YES votes than NO votes, due to the \$25M hit to the City, if this does not pass. Committee Member Hollingworth stated he understands, and pointed out this is why he wants to tie the actions together for both items.

Chairperson Peugh stated a motion will be held off for now, until discussion of Item 9 below.

After discussing Item 9 below, Committee Member Billings commented other than the symbolic value, there are financial implications that are negative for the Department. He then moved to support the Notice proceeding. Committee Member Collins seconded the motion. With Committee Member Hollingworth voting NO, and no abstentions, all others were in favor to support the Notice proceeding.

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9. Draft IROC Report on the Metropolitan Water District and County Water Authority Rate Increases

Committee Member Hollingworth stated there have been hearings over the past several months with CFO's of MWD and (San Diego County Water Authority) SDCWA which many have participated in. He also indicated he reviewed several studies which looked at budgets, rate setting, and cost structure of the MWD. He stated he feels there is no way to influence water rates at the retail level unless they are influenced at the wholesale level. He proposed in an attempt to do this and bring some sort of control over the increases, he asked that the Committee support an action which would be to recommend to the Mayor and City Council they contact our State Legislators in the Assembly and Senate and seek the inclusion of language in the State budget mandating an outside audit of MWD rates and cost structures, coming up with specific recommendations on how they can be restructured to mitigate future water rate increases until the California economy is recovered.

Mr. Hollingworth added a portion of the work has been done at a higher level. Bartle and Wells & Associates and Glenn M. Reiter & Associates have already looked at MWD's cost structures, but this can be built on. He then recommended the team include either the State Controller's Office, the Bureau of Public Audits, or the Legislative Analyst's Office. He gave examples of their work. He also recommended the Mayor and City Council support the SDCWA negotiations and lawsuit against MWD.

He stated a more immoderate approach, if needed, would be to propose to the Mayor and City Council, the same action SDCWA proposed, which would be to institute a "hard" MWD hiring freeze, no new expenditures other than for water purchase, and they review and reduce near term Capital Improvement Program expenditures to help California get through the recession.

Mr. Hollingworth then recommended as part of the recommendation of a rate increase, that IROC approve the draft Report, which would be forwarded to the Mayor and Council with the recommendation they do take action in the attempt to get at the underlying cause of the rate increases.

At this time, Tom Zeleny, Deputy City Attorney polled the IROC, because the draft Report has the recommendation of hiring two specific firms, asking if any member of the IROC has any financial interest in the two listed firms. It was confirmed that none of the members have any financial interest.

Committee Member Hollingworth moved to support moving forward with a request for the state legislature to mandate an outside audit of MWD, Committee Member Stallard-Rodriguez seconded the motion.

More discussion began. Committee Member Billings stated he is not in a position to vote at this time. Chairperson Peugh listed his reservations about certain

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aspects of the recommendations listed by Committee Member Hollingworth. Committee Member Billings asked Committee Member Hollingworth who can direct an audit of MWD. Committee Member Hollingworth explained MWD was established by an act of the Legislature, and is therefore subject to mandates enacted through the State budget. The legislature has used budget language, to mandate audits of other types. He then gave examples of the CalPers and State Parks System audits which he participated in; and noted they have not previously mandated a study through the State budget of the Metropolitan Water District. He stated an audit would be the way to go.

Chairperson Peugh asked Ms. Steirer if there are routine audits by the agencies that contribute to them? Ms. Steirer stated the Member Agencies do. She mentioned for example with SDCWA, they have staff located in Los Angeles that follow everything that MWD does. She also mentioned that San Diego has four delegates on the MWD Board who have been closely following this rates issue. Committee Member Hollingworth then commented that the MWD Board members recommend they not adopt their budget due to their concerns with the sense they are not being listened to. Committee Member Billings stated he shares his concerns, however cannot agree with some of the recommendations until he has more time to digest the materials.

Committee Member Hollingworth stated the Audit would be a first step to recommend the policy changes. His main areas of focus would be compensation, CIP including scheduling and the use of pay-go (instead of long-term financing), how they allocate cost to the transportation rate. He stated the large rate increases will continue if this is not addressed. Committee Member Billings commented he is not comfortable supporting all of the actions. Chairperson Peugh concurred. Committee Member Hollingworth added because of the timing of the rate increase, this vote should not be delayed.

A roll call vote was taken by Monica Musaraca. With Committee Members Hollingworth and Webster voting YES to support moving forward with a request for the state legislature to mandate an outside audit of MWD, Committee Member Dull being absent, all other members voted NO, and the motion failed.

Chairperson Peugh asked for any other motions. Committee Member Stallard-Rodriguez made a motion to bring this item back for further discussion of the document. Committee Member Billings seconded the motion. With Committee Member Dull being absent, all were in favor, and the motion passed.

10. Proposed Agenda Items for the Next IROC Meeting

None at this time.

11. IROC Members' Comments

Committee Member Stallard-Rodriguez complimented Committee Member Hollingworth on his hard work on the provided document for Item 9.

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Adjournment of IROC

At 12:14 Chairperson Peugh adjourned the meeting.

Recording Secretary: _____
Monica Musaraca