

# Letters from Wholesale Customers to IROC & NR&C June & July 2013

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*...Dedicated to Community Service*

2554 SWEETWATER SPRINGS BOULEVARD, SPRING VALLEY, CALIFORNIA 91978-2004  
TELEPHONE: 670-2222, AREA CODE 619

[www.otaywater.gov](http://www.otaywater.gov)

July 10, 2013

The Committee on Natural Resources and Culture  
of the City Council of the City of San Diego  
Councilmember David Alvarez, Chair  
Councilmember Scott Sherman, Vice Chair  
Councilmember Marti Emerald  
Councilmember Lorie Zapf

Dear Committee Members:

The Otay Water District requests that the City of San Diego's Natural Resources and Culture Committee (NR&C Committee) defer moving Agenda Item 5, Non-Potable Recycled Water Pricing Study, forward to the City Council.

The District believes that the Non-Potable Recycled Water Pricing Study contains inaccurate cost accounting and factual errors. As such, it will not support findings and conclusions that are required under Propositions 218 and 26 for the City Council to vote on rate increases.

The original Raftelis study, with the support of City staff, recommends rate increases of 180% for recycled water customers in one year. For a customer like Otay, the rate we pay would go from \$350 per acre-foot to \$1,500 per acre-foot. That's more than four times what retail customers currently pay. On July 2, 2013 City staff developed an Addendum to the Study that addresses some of Otay's concerns, but it is still seriously flawed and is lacking detail of justifiable costs. The impact of such a drastic increase would devastate recycled water customers. Such an increase would also negatively affect demand for recycled water, and this is contrary to the City's plans to expand recycled water use as anticipated under the current Metro Wastewater Plan and Point Loma Waiver.

When the Raftelis draft study was last released in 2009, Otay and other recycled water stakeholders raised serious concerns about the report. At the time, we were given assurances our concerns would be considered and stakeholders would be given adequate time to review the next report. That hasn't happened. Now the report is being rushed through to your Council without it being vetted by the stakeholders. In addition, the IROC had also expressed serious concerns with the Study and it was understood that City staff would bring it back to the IROC members before it was presented to the NR&C Committee. To this date, this still hasn't happened.

There are many flaws with this study, including:

- This cost of service study (COSS) is not fair and equitable
- Does not consider wholesale versus retail rate; the zone rates in option 2 attempts to correct this, but is still flawed
- City staff, in the rush to push this report through the process, has discovered errors and made changes to costs late in the process raising concerns about how many other mistakes are in the study, undetected due to the haste to take this to City Council
- Appears to double count debt on the sewer side and water side
- Impossible from the study to determine where numbers are derived from
- Inconsistent with costs given to Metro Commission (Metro JPA) on sharing of revenues based on recycled operations and maintenance costs, as required in the Regional Agreement
- Peaking analysis is not based on industry standard, particularly with regard to wholesale customers
- Fails to explain penalty to Otay Water District (Otay) from “take or pay,” causing an increase of 327% in option one
- Fails to recognize that Metro is not a unitary system. Metro has retail customer (City of San Diego residents) and wholesale customers (participating agencies) with different rates and their own distribution systems
- In both options costs are still not allocated correctly and does not appear to have gone through the properly quality control review process by City staff

The District appreciates your consideration of the above and believes the City will be well advised to follow a more transparent approach to rate setting; one that will comply with industry standard and State law.

We will be happy to continue to participate in a constructive dialogue, share our comments and concerns as we have since 2009 when the Raftelis Study first surfaced.

Sincerely,



Mark Watton,  
General Manager





*...Dedicated to Community Service*

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July 9, 2013

The Honorable Bob Filner  
City Administration Building  
202 C Street, 11<sup>th</sup> Floor  
San Diego, CA 92101

Dear Mayor Filner:

Thank you for giving us the opportunity to share information with you concerning the City of San Diego's Recycled Water Pricing Study Report (Study). Please find enclosed a list of the revised Otay Water District (Otay) concerns with the Study prepared by Raftelis Financial Consultants Inc. (Raftelis). In short, we view the Study, and the process by which it is being brought before your Council, as being seriously flawed.

Consequently, the District asks that the City consider deferring review by the NR&C Committee until the stakeholders concerns have been addressed.

The original Raftelis study, with the support of City staff, recommends rate increases of 180% for recycled water customers in one year. For a customer like Otay, the rate we pay would go from \$350 per acre-foot to \$1,500 per acre-foot. That's more than four times what retail customers currently pay. On July 2, 2013 City staff developed an Addendum to the Study that addresses some of Otay's concerns, but it is still seriously flawed and is lacking detail of justifiable costs. The impact of such a drastic increase would devastate recycled water customers. Such an increase would also negatively affect demand for recycled water, and this is contrary to the City's plans to expand recycled water use.

When the Raftelis study was first released in 2009, Otay and other recycled water stakeholders raised serious concerns about the report. At the time, we were given assurances our concerns would be considered and stakeholders would be given adequate time to review the next report. That hasn't happened. Now the report is being rushed through to your Council without it being vetted by the stakeholders. In addition, the IROC had also expressed serious concerns with the Study and it was understood that City staff would bring it back to the IROC members before it was presented to the NR&C Committee. To this date, this still hasn't happened.

Let me close in expressing our appreciation for the opportunity to share this information with your office. We would also like to stress that this is not just an issue between the Otay and the City. Raising recycled water rates 180% or 300% is an issue of concern to every recycled water

customer. Please feel free to contact my office directly at 619-670-2280 for any additional information you may require.

Sincerely,



Mark Watton  
General Manager

cc: Board of Directors, OWD  
Roger Bailey, Public Utilities Director  
Ann Sasaki, Assistant Public Utilities Director  
Lee Ann Jones-Santos, Deputy Director Finance  
IROC Committee Members  
Metro Commissioners  
Metro TAC Representatives

Attachment

**Otay Water District Concerns with City of San Diego  
Recycled Water Pricing Study Report  
Dated June 19, 2013**

**Prepared by Raftelis, Financial Consultants, Inc.**

**To be presented to NR&C on July 10, 2013**

- The report presented to IROC on June 24, 2013 recommends a 180% rate increase for recycled customers in one year, from \$0.80 per hcf to \$2.241 per hcf effective January 1, 2014. An Addendum issued by City staff on July 2, 2013 recommends a 300% rate increase for North City recycled customers from \$0.80 to \$3.208 and a 62.5% rate increase for South Bay from \$0.80 to \$1.30. As a result of such drastic increases, the demand for recycled water would drop, which is the opposite of the City's plan to expand recycled water use in the region.
- There are many flaws with this study, including:
  - This cost of service study (COSS) is not fair and equitable
  - Does not consider wholesale versus retail rate; the zone rates in option 2 attempts to correct this, but is still flawed
  - City staff, in the rush to push this report through the process, has discovered errors and made changes to costs late in the process raising concerns about how many other mistakes are in the study, undetected due to the haste to take this to City Council
  - Appears to double count debt on the sewer side and water side
  - Impossible from the study to determine where numbers are derived from
  - Inconsistent with costs given to Metro Commission (Metro JPA) on sharing of revenues based on recycled operations and maintenance costs, as required in the Regional Agreement
  - Peaking analysis is not based on industry standard, particularly with regard to wholesale customers
  - Fails to explain penalty to Otay Water District (Otay) from "take or pay," causing an increase of 327% in option one
  - Fails to recognize that Metro is not a unitary system. Metro has retail customer (City of San Diego residents) and wholesale customers (participating agencies) with different rates and their own distribution systems
  - In both options costs are still not allocated correctly and does not appear to have gone through the properly quality control review process by City staff
- This study was not presented to the Metro JPA, which is a formal advisory commission of the City Council. Pursuant to Regional Agreements, the Metro JPA shares in 36% of Metro costs, as well as sharing in the recycled revenues. In fact, in 2009, when this report was last released, City staff provided assurances that Metro JPA's comments would be considered



and that adequate time to review the next report would be given. Few, if any, of the comments were addressed, however, and the study was released only days before the City's IROC meeting.

- City staff is not responsive to issues related to recycled water. The City has been using Otay's recycled reservoir and disinfection system, an estimated value of \$417,000, without rights and without payment to Otay for this usage for years. Otay has repeatedly requested to resolve this matter and City staff will not engage in this discussion.
- Otay has invested nearly \$200 million dollars in its recycled system and in fact maintains and operates the largest recycled water distribution system in San Diego County. Despite this investment, the study treats Otay as a retail customer even though Otay does not use any of the City's distribution facilities.
- Otay has a "take or pay" clause in its agreement with the City. If added, the option one proposed rate increase and the "take or pay" will result in Otay paying \$1,500 per acre foot (AF) - over 4 times what retail customers currently pay. The increased rate would be \$400 more per AF than imported potable water and \$520 more per AF than what retail recycled customers pay. A rate of \$1,500 per AF rate is unsustainable.
- Otay is concerned that City staff seems to be forcing this report through the process without vetting by the proper recycled water stakeholders. The Potable COSS was vetted with IROC for six months. As touched on above, this recycled study has not been vetted with IROC, MetroTAC, Metro JPA nor by retail and wholesale customers, resulting in an apparent lack of transparency. Additionally, this study does not use industry standards in rate setting, and lacks apparent consideration to standing contracts with other agencies.
- On June 24, 2013 the IROC Commissioners were made aware of and understood flaws with this study and made a motion to bring back the study to IROC at their next meeting to have a discussion about the nexus between treating the recycled system as unitary vs. non-unitary, and the impact on the demand for the recycled product. IROC directed staff to revisit this issue and look at the potential for wholesale versus retail rates. This report needs to be sufficiently vetted prior to attempting to adopt rates which are not based on cost of service, particularly due to restrictions set forth in laws such as Proposition 218 and Proposition 26. The next IROC meeting is after the July 10<sup>th</sup> NR&C Committee meeting, therefore IROC concerns have not been properly addressed.
- The study doesn't address the price elasticity for recycled water and the impact that this drastic rate increase will have, greatly reduce the demand for recycled water and the corresponding drop in City revenues.
- City staff have concerns of a Shames type lawsuit (UCAN) similar to sewer, but due to the nature of recycled water benefiting both sewer and potable, this would not apply.

# CITY OF POWAY

DON HIGGINSON, Mayor  
JOHN MULLIN, Deputy Mayor  
JIM CUNNINGHAM, Councilmember  
DAVE GROSCI, Councilmember  
STEVE VAUS, Councilmember



July 9, 2013

Councilmember David Alvarez, Chair  
Natural Resources & Culture Committee  
City of San Diego  
202 C Street  
San Diego, CA 92101

Dear Councilmember Alvarez:

This letter is sent regarding the City of San Diego Recycled Water Pricing Study scheduled for consideration at the July 10, 2013 meeting of the Natural Resources & Culture Committee.

As a Participating Agency in the Metropolitan Wastewater Joint Powers Authority and a contract purchaser of recycled water from the City of San Diego since 1997, the City of Poway respectfully requests that the Recycled Water Pricing Study be continued to a future meeting to allow for further discussion and consideration.

We are most concerned with the recommendation to implement a unitary rate. An increase of 180% to 300% creates an enormous disincentive for wholesale customers to purchase the City of San Diego's reclaimed water. The rates must be fair and equitable to all parties, and must be set at appropriate levels that balance the facilitation of increased use of reclaimed water per the City of San Diego's agreement with the environmental community and the subsequent \$2 million Recycled Water study.

Although it does not appear that Poway's purchase contract would be immediately affected, the precedential nature of the pricing philosophy and structure as well as the lack of stakeholder process raise specific issues as summarized below:

- The study does not sufficiently define or explain the selected dividing point for distribution of recycled water expenses between the wastewater and water functions;
- The study lacks adequate detail explaining how the included costs were calculated; and,
- The study recommends only a retail rate failing to consider that wholesale customers such as the City of Poway, Otay Municipal Water District, and the Olivenhain Municipal Water District may also need to include charges for aspects such as customer service, meter reading, and local infrastructure.

In regard to process, the Technical Advisory Committee (TAC) and recycled water stakeholders raised numerous issues with the Raftelis study when it was first released in 2009. Five years later, despite promises that stakeholder perspectives would be considered and that adequate time would be given to review the next report, the new report is on a fast track to San Diego's City Council without any stakeholder inclusion

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occurring during the intervening years. This is troublesome since TAC has regularly requested updates on the status of the study only to be told that the report was not yet available. TAC received the same response to its latest inquiry, made at its June 19, 2013 Meeting, and were surprised to learn that the report was released with the IROC agenda that afternoon without a courtesy call or copy being provided to TAC or wholesale customers. To date, the study has still not officially been shared with either TAC, the Metro Board or wholesale customers.

Although perhaps unintended, this approach sends a message of disregard for the important relationship between the City and its Metro partners. As the City of San Diego and Participating Agencies prepare to undertake discussions this year regarding the most critical issue of cost-sharing for the proposed Advance Water Purification project, this is a time when collaborative discussions and stakeholder engagement are vital to achieve outcomes that have the potential to benefit not only the City of San Diego, but the entire region for many generations to come.

Thank you for considering the City of Poway's request to delay any decisions on the Recycled Water Pricing Study in order to allow for necessary stakeholder participation with the goal of ensuring fair and equitable rates within the larger context.

Respectfully Submitted,



Leah Browder  
Director of Public Works  
Utilities General Manager

- c: Members of the City of San Diego Natural Resources & Culture Committee
- Metropolitan Wastewater Joint Powers Authority Board Members
- Metropolitan Wastewater Joint Powers Authority Technical Advisory Committee
- Penny Riley, City Manager, City of Poway
- Roger Bailey, Director, City of San Diego Public Utilities Department
- Ann Sasaki, Assistant Director, City of San Diego Public Utilities Department
- Lee Ann Jones-Santos, Deputy Director, City of San Diego Public Utilities Department

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**General Manager**

Kimberly A. Thorner, Esq.  
**General Counsel**  
Alfred Smith, Esq.

July 9, 2013

Councilman David Alvarez  
Chair, Natural Resources & Culture Committee  
City of San Diego  
202 C Street  
San Diego, CA 92101

**Re: City of San Diego Recycled Water Pricing Study**

Dear Councilman Alvarez,

It was brought to the attention of Olivenhain Municipal Water District today by members of the Metropolitan Wastewater Joint Powers Authority that a Recycled Water Pricing Study is scheduled for consideration at the July 10 meeting of the Natural Resources & Culture Committee.

As a long-time partner of the City of San Diego that is contractually obligated to purchase several thousand acre-feet of recycled water from the city through 2024, OMWD respectfully requests that the Recycled Water Pricing Study be postponed until a future meeting of the committee in order to allow us adequate time to review and consider the study and its implications to our budget and our ratepayers, many of whom are residents of the city.

The drastic nature of proposed rate increase may potentially impact the level of cooperation that we have enjoyed with the city as established in our two recycled water purchase agreements. Given that OMWD may need to comprehensively review the sources for our recycled water distribution system over the long-term, postponing the committee's review of the Recycled Water Pricing Study to allow partner agencies adequate time for review would be an appropriate and considerate step.

If you should need any additional information, please do not hesitate to contact me at 760-753-6466. Thank you for your consideration.

Regards,

A handwritten signature in black ink, appearing to read "Kimberly A. Thorner".

Kimberly Thorner  
General Manager



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