

March 7, 2022

MEMBER AGENCIES

Carlsbad
Municipal Water District
City of Del Mar
City of Escondido
City of National City
City of Oceanside
City of Poway
City of San Diego

Fallbrook
Public Utility District
Helix Water District
Lakeside Water District

Olivenhain
Municipal Water District

Otay Water District

Padre Dam
Municipal Water District

Camp Pendleton
Marine Corps Base

Rainbow
Municipal Water District

Ramona
Municipal Water District

Rincon del Diablo
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Vista Irrigation District

Yuima
Municipal Water District

OTHER
REPRESENTATIVE

County of San Diego

VIA EMAIL

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RE: Item 7C LAFCO March 7, 2022 Meeting

Dear Mr. Simonds:

This letter is in regard to the March 7 LAFCO meeting, and most particularly the summary provided by you on Item 7C of Dr. Michael Hanemann's expert report. The letter, and my oral public remarks at the meeting, are provided as comment by the San Diego County Water Authority's ("Water Authority") Office of General Counsel on behalf of the Water Authority. We ask that you provide this letter to the LAFCO Commissioners and to the Ad Hoc Advisory Committee members, and that it be made part of the record.

As you know, Dr. Hanemann was contracted by LAFCO to address certain areas related to the reorganization applications filed by Fallbrook Public Utility District ("Fallbrook") and Rainbow Municipal Water District ("Rainbow") because LAFCO staff lacks expertise in these areas.¹ The parties to the reorganization proposals, as well as the Water Authority, ratified Dr. Hanemann as the expert to assist LAFCO staff. You have now provided to the Commissioners your own "condensed cliff-notes" on the three topics addressed in Dr. Hanemann's expert report, along with a full copy of the report.

We appreciate that the Commission is being provided a full copy of Dr. Hanemann's expert LAFCO report because this document is critical for LAFCO's ultimate review of the pending reorganization applications. Dr. Hanemann covers at an appropriate level of detail the issues assigned to him: water reliability, water rates, and potential departure fees.² His analysis is critical for consideration not just by LAFCO staff and Commissioners, but by the water ratepayers in the Fallbrook and Rainbow service areas.

¹ As noted from the outset of these proceedings, the detachments present questions of first impression at LAFCO.

² There are other important issues beyond the scope of Dr. Hanemann's work, as addressed by the Water Authority in separate earlier correspondence to LAFCO.

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Given the material discrepancy between what those ratepayers have been told³ and the facts as determined by Dr. Hanemann, we urge you and the LAFCO Commissioners to ensure those ratepayers receive notice of the report and where it can be located so they can read the report, in its entirety, for themselves.

The primary purpose of this letter is to alert the Commissioners and the Ad Hoc Committee members that we believe many of the fundamental points raised in Dr. Hanemann's expert report have been inaccurately summarized.⁴ You state that you are providing "condensed cliff-notes on all three topics covered in the final report," and go on to provide a few bullet points on the Hanemann-assigned topics of water supply reliability, financial impacts, and potential exit fees. However, even allowing for the inherent challenge of trying to reduce Dr. Hanemann's 114-page expert report to a few bullet points, in each area material errors and omissions are made that we bring to the attention of the Commission.

Water Supply Reliability

Your summary of the LAFCO Hanemann report correctly states that Dr. Hanemann found that the Water Authority's supply was more reliable than Eastern's "wholesale" supplies (i.e., water from Metropolitan Water District of Southern California ("MWD")). However, your summary then makes the unfounded claim that Dr. Hanemann concluded that MWD has a reliable wholesale supply, and that he "does not find the reliability differences between the two (Water Authority and MWD) are substantive relative to industry standards." Both statements are direct contradictions of the LAFCO Hanemann report. Indeed, Dr. Hanemann states the very opposite of what the "cliff-notes" summary concludes on these points.

First, Dr. Hanemann notes that if LAFCO allows the reorganization requests, Rainbow and Fallbrook will not have access to Eastern's supplies, but will rely totally on imported water from MWD:

While about half of EMWD's supply is local supplies, it does not share those with its wholesale customers. Under the present arrangement, if FPUD and RMWD become members of EMWD this will not bring them access to any of EMWD's local supply. Through EMWD they will receive only M-water from MWD. (Report, p.14.)

Dr. Hanemann then addresses the material differences in reliability between the Water Authority and MWD:

³ Fallbrook and Rainbow customers are still being misled by the agencies to believe that they will "get the same water" and "equally reliable" water (<https://www.ratepayersforwaterchoice.com/>), allegations directly refuted by LAFCO's expert Dr. Hanemann: "Is it the case that, if FPUD and RMWD exit from SDCWA, they still would end up receiving the same water from the same turnouts on the same pipes? Nothing would really change?" Dr. Hanemann's response: "No – that is not the case...It is different in source, it is different in supply reliability, and it is different in pricing." Report, p. 28, and see below quotes on reliability. The website, which is promoted as being by and on behalf of ratepayers, is really just part of a campaign by Fallbrook and Rainbow. The website continues to make numerous claims that have been refuted by LAFCO's expert and does not even provide a link to his report.

⁴ Dr. Hanemann's own Executive Summary of his report is 12 pages long (pp. 7-18).

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Both of MWD's sources of M-water -- SWP water and Colorado River water -- have supply reliability issues. (Report, p.14. Emphasis added.)⁵

Dr. Hanemann then walks through those issues. First, he points out that MWD's State Water Project Water is not reliable:

There are supply reliability issues for SWP water with regard to: (i) the amount of water available for it to take from its source, the Feather River in the Sacramento Valley, and (ii) the ability to convey that water through the Sacramento/San Joaquin Delta to SWP member agencies south of the Delta. (Report, p.15. Emphasis added.)

Dr. Hanemann then notes that MWD's other supply, the Colorado River, is mainly a junior water right subject to cutbacks, unlike the Water Authority's higher rights on the Colorado River via its conserved water from the Imperial Valley:

The Colorado River was MWD's original source of water and remained its larger source until the QSA took effect in 2003, reducing MWD's firm supply of Colorado River water. Starting in 2003, SWP made up the majority of MWD's water. The recent difficulties with SWP deliveries are causing a return to Colorado River water. However, there has been a twenty-year drought on the Colorado River, and the impacts are now beginning to be felt. . . . In the event of a California reduction, the brunt would be borne by MWD, not SDCWA, because of the seniority of the water right to which SDCWA has access. (Report, p.15. Emphasis added.)

Dr. Hanemann also points out that MWD's Colorado River supplies, on which Fallbrook and Rainbow would rely, are at risk:

It is not clear that MWD yet has the practical capacity to sustain more severe and prolonged drought, especially on the Colorado River. (Report, p.16.)

Finally, Dr. Hanemann points out that Eastern's claimed ability to meet the needs of Fallbrook and Rainbow when MWD runs short of water and goes into allocation is not credible:

EMWD presented an analysis showing that it would be able in a drought to withstand a 30% reduction in MWD deliveries, sparing any wholesale customer (including

⁵ MWD does not disagree with Dr. Hanemann's conclusion. In a memo from the MWD General Manager dated March 8, 2022, he states:

Today we face a reliability challenge. Climate change has and continues to have considerable impacts on our imported supplies. As Southern California enters a third drought year, impacts to the State Water Project highlight vulnerabilities of portions of our service area. On our other imported supply, chronic aridification of the Colorado River watershed began accelerating 20 years ago and shows us that vast amounts of storage alone cannot single-handedly stabilize a river at risk. Simultaneous drought in both imported supply systems and within Southern California—called a “perfect drought”—threatens the continued performance of our mission without new approaches to planning, innovation, and leadership. <https://mwdh2o.legistar.com/View.ashx?M=F&ID=10572391&GUID=29B8A2B7-D16E-4F00-8063-AEA0D82AC14C> at p. 3. The reason the Water Authority's rates are higher at this moment in time is that it began to plan and invest more than a decade ago.

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FPUD and RMWD) from being short of supply. However, that analysis rests on certain assumptions which I find unrealistic. (Report, p.16. Emphasis added.)

Q. Suppose FPUD and RMWD join EMWD and, some time thereafter, MWD faces a shortage of water and imposes an allocation on its member agencies including EMWD. Will FPUD and RMWD experience the same degree of shortage as other member agencies served by EMWD? A. They may face a larger degree of shortage than some other EMWD wholesale customers. (Report, p.96. Emphasis added.)

These water supply reliability differentials between the Water Authority and MWD are so material that Dr. Hanemann concluded that switching water providers would create a risk for Fallbrook and Rainbow that they would actually have to pay more for water than they expect:

In summary, while I believe that FPUD and RMWD are taking something of a gamble on supply reliability if they switch from SDCWA to EMWD, the gamble ultimately is not one of running out of water but, rather, paying a higher price than they had anticipated to get by in a drought. (Report, p.16. Emphasis added.)

There is absolutely nothing in LAFCO's Hanemann report that says the above material differences in supply reliability are not "substantive relative to industry standards," as asserted by the "cliff-notes" summary provided to the Commission. Indeed, the LAFCO Hanemann report reaches the directly contrary conclusion: that there are meaningful differences in supply reliability, and that this difference results in a "gamble" by Fallbrook and Rainbow in making a move. Further, Dr. Hanemann expressly found that, "the superior reliability of SDCWA's supply has benefitted FPUD and RMWD..." (Report, p.14. Emphasis added.)

Fortunately, the Commission has been provided the actual Hanemann report and the Commissioners can read it for themselves. We urge them to do so.

Water Rates

On the subject of water rates, your "cliff-notes" summary provides annual estimated cost savings for Fallbrook and Rainbow that were noted by Dr. Hanemann. However, your summary omits the critical caveat which his report stated on this subject: these listed annual savings may be transitory and can vanish.

Dr. Hanemann's report walks through the infrastructure expenditure cycles that the Water Authority and MWD have been in, and notes that one key reason for today's price differential between the two agencies is that the Water Authority has just concluded its expenditure cycle, while MWD is just embarking on a large one:

Due to the happenstance of timing, SDCWA was significantly upgrading its storage and distribution infrastructure at a time when MWD was not making any unusually large infrastructure investments. This will be reversed in the future as MWD engages with the Delta Conveyance Project. (Report, p.99. Emphasis added.)

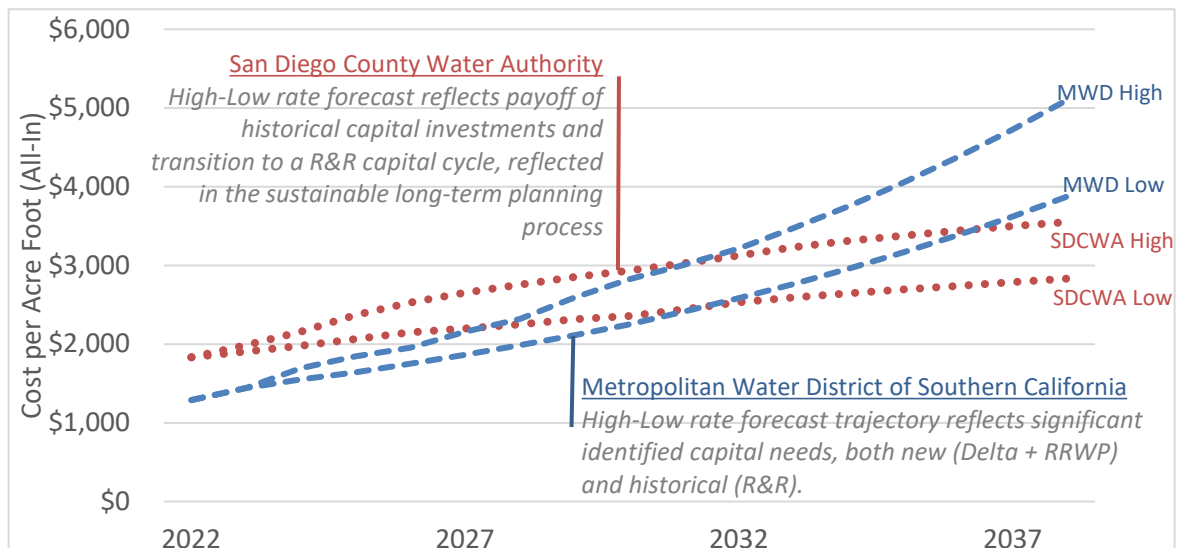
Q. Will the differential between SDCWA water rates and MWD water rates stay this wide in future, or widen, or become smaller? A. I don't know. The recent trend has been for the average cost of M-water to SDCWA to grow faster than the that of QSA water. That would tend to narrow the differential between SDCWA's all-in rate and MWD's all-in rate. (Report, p.61. Emphasis added.)

Indeed, MWD has just presented its two-year budget for calendar years 2023 and 2024, proposing a 16-17% water rate increase.⁶ Our agency's Finance staff has projected that given the capital outlays now being planned by MWD, over the next 16 years MWD's rate increases will be significantly higher than those of the Water Authority, for exactly the reasons noted by Dr. Hanemann. Here are the estimated rate increases for each agency for that 16-year period:

Metropolitan Water District: 7.1% to 9.0% per year increases

San Diego County Water Authority: 2.8% to 4.2% per year increases

The "cliff-notes" summary of financial impacts is therefore highly misleading, because it omits entirely Dr. Hanemann's own conclusion that the agencies are in different construction cycles, and that MWD's rates will increase with its investments such that any price gap can close. According to the Water Authority's analysis on these facts, the rate differential lines will soon cross:⁷



Dr. Hanemann's expert LAFCO report appropriately presents the subject analyses, i.e., how did we get where we are today and what are the risks for both wholesale suppliers in the future? But the "cliff-notes" summary fails to capture any of the relevant facts and circumstances described in Dr. Hanemann's expert report, failing to capture his findings

⁶ See MWD's proposed 2023 and 2024 budget and rates:

<http://mwdh2o.legistar.com/gateway.aspx?M=F&ID=35e3a613-fae3-4e77-944c-91678d9f0fa7.pdf>

⁷ Leaving aside any difference of opinion we have about what the amount and term of an appropriate potential exit fee should be, suffice it to say that if LAFCO agrees with its own expert consultant, then payments due from Fallbrook and Rainbow could be greater than any near-term cost savings from detachment.

about reliability and rates. In short, the Water Authority began years ago to plan and finance a reliable water supply which it can now count on, today and for the foreseeable future. MWD, on the other hand, is just beginning this phase of supply investment to ensure its future reliability, the cost and success of which is not yet known.⁸

A final note on “industry standards,” referred to in the third “cliff-notes” bullet on water supply reliability. The transition sought by Fallbrook and Rainbow to cease using available local water supplies in order to purchase more MWD water, which is substantially more dependent on the Bay Delta, is *inconsistent* with industry standards and state water law favoring local and regional water supply investment and sustainability. While the citations are too numerous to include here, see the discussion at pp. 18-39, 96-100 and 170-174 of the Water Authority’s Combined Response to Reorganization Applications by Fallbrook and Rainbow; see also California Water Plan <https://water.ca.gov/programs/california-water-plan>.

Potential Exit Fee

Your “cliff-notes” summary fails to reference Dr. Hanemann’s statement of the fundamental question he believes the Commissioners need to address on this topic:

The question confronting LAFCO is whether two SDCWA member agencies with a distinctive set of needs and situated at a distinctive location *should be allowed to walk away scot-free, entirely unencumbered by any of the financial commitments that SDCWA has assumed on behalf of its member agencies.* (Report, p.13. Emphasis added))

Dr. Hanemann’s own answer was, unequivocally, that the agencies should not be able to walk away “scot-free.” He stated on page 73: “Q. Is there a sound economic justification for imposing some continuing financial obligation? A. Yes.”

While the Water Authority has different views on various aspects of this particular issue, which need not be fully addressed at this time, we note to the Commissioners that *the question of an “exit fee” should never be reached at all, because the applications should be denied on multiple grounds.* Why? Because, among other reasons, the applicants have failed to demonstrate any meaningful benefit to their own customers,⁹ and they cannot justify San Diego County losing voting rights at MWD. There is no reason why San Diego County should allow its voting rights at MWD to be diminished by allowing land in our county to be shifted into a Riverside County agency, and water planning for parts of our County also to be shifted away, thus harming water ratepayers and taxpayers across

⁸ As stated on prior occasions, these statements are not intended as any criticism of MWD, only to acknowledge the facts that 1) it will need to make, and is planning to make, multi-billion dollar investments for reliability; and 2) it will need to raise rates in order to do so. As Dr. Hanemann has described, the agencies will be taking a “gamble” if they move to Eastern in order to become 100% reliant on MWD water.

⁹ As noted above, pricing between MWD and the Water Authority is closing. Also, even if Fallbrook and Rainbow exit fees were limited to those suggested by Dr. Hanemann, payment of those fees would negate even the modest near-term rate projected rate differential.

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San Diego County. These issues were beyond the scope of what was assigned to Dr. Hanemann, and so understandably were not addressed by him.

Conclusion

In conclusion, our agency is very appreciative of the Commission and Ad Hoc Committee's attempts to deal with these complex matters, including water issues that are critical for San Diego County and statewide. We are also thankful for the very thoughtful work done by Dr. Hanemann, and we believe his report is fundamental reading for all those dealing with the reorganization applications.

We look forward to continued participation with the Commission and the Ad Hoc Advisory Committee in these important matters. Thank you.

Sincerely,



Mark J. Hattam
General Counsel

Cc via email:

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