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March 15, 2022

TO: Santa Clarita Valley Water Agency Board of Directors

FROM: Ichiko Kido, Ratepayer's Advocate, Robert D. Niehaus, Inc.

SUBJECT: Review of Wholesale Water Rate Calculation and Methodology

After a thorough review of the wholesale rate model as well as the report prepared for the Finance Committee by Santa Clarita Valley Water Agency (SCV Water, Agency) staff, I am writing to inform the SCV Water Board of Directors that the rates developed for the wholesale customer, specifically the Los Angeles County Waterworks District No. 36 (District 36, District), are reasonable and defensible as they follow the basic rate-making principles of cost allocation and a rate development methodology endorsed in American Water Works Association( AWWA) *Manual 1: Principles of Water Rates, Fees and Charges* (M1).

Wholesale water rates usually are developed by isolating operational and capital costs associated with wholesale water service and proportionally allocating the total system revenue requirements to wholesale water customers. This methodology created a challenge for SCV Water as District 36 water use, especially in recent years, is quite sporadic. Agency staff concluded that SCV Water provides standby service to the District, where the cost of reserving the capacity to serve the District should be primarily considered in the rate development. This memo provides the rationale for selecting such a method and justifies the Agency's decision to develop wholesale water rates using the approach. Our analysis aligns with the industry standards defined in the AWWA M1.

I recommend that SCV Water 1) monitor the volume of water purchased by the District and reevaluate the standby rate methodology if revenue consistently exceeds projections, and 2) ensure that revenue from the wholesale water rates is used to execute future capital improvement projects which benefit both the retail and wholesale customers.

Enclosed is a summary of my review discussing key points in evaluating and validating the methodology and principles used by Agency Staff to develop standby service rates.<sup>1</sup>

If you have any questions, please feel free to email me at [Ichiko@rdniehaus.com](mailto:Ichiko@rdniehaus.com).

Sincerely,



Ichiko Kido, MBA  
Ratepayer Advocate  
Robert D. Niehaus, Inc.

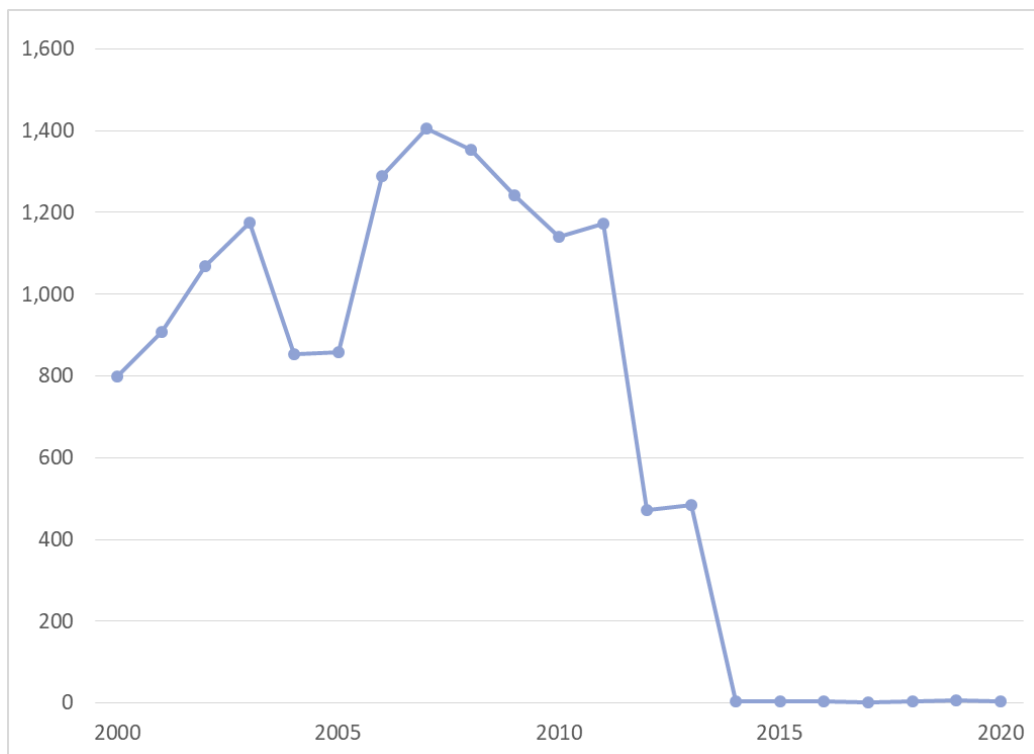
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<sup>1</sup> Wholesale water rates are not “standby charges” for purposes of article XIII D of the California constitution. They are not imposed on property or as an incident of property ownership and relate to costs associated with providing wholesale water service to the customer.

## Standby Service Rates for Wholesale Water

Water purchases from District 36 have significantly decreased in the last decade. This created a challenge in accurately projecting revenue from future wholesale water sales. Estimating the appropriate level of proportional cost-share and allocating the cost to District 36 as part of the revenue requirements of the entire system would be difficult and risky as they may not purchase any water in some years. Figure 1 shows the volume of water purchased by District 36 over the past 20 years.

**Figure 1. Purchased Water by District 36, FY 2000 - FY 2020**



Note: the purchased water includes local production from Alluvium and Saugus Formation

Agency staff determined that standby or backup water service is the most appropriate description of the service offered to District 36, considering the unique relationship the two utilities currently maintain.

AWWA M 1 suggests that the development of standby service rates for wholesale rates should be considered when:

- A utility places random, infrequent loads on another utility's system

- A water utility wishes to acquire finished potable water from an outside source in the event of an interruption or temporary lack of access to the source water supply
- A water utility pursues arrangements for standby water service to back up their water supply
- The water utility providing standby service has the necessary reserve capacity to supply the level of standby demand requested by another utility without compromising the safe yield commitment and operational integrity to its customers
- Transmission main interconnections are in place to transfer the water on demand

The Ratepayer Advocate examined the defensibility of developing rates based on four evaluation criteria identified in M1: equity, revenue stability, impact on retail water customers, and conservation.

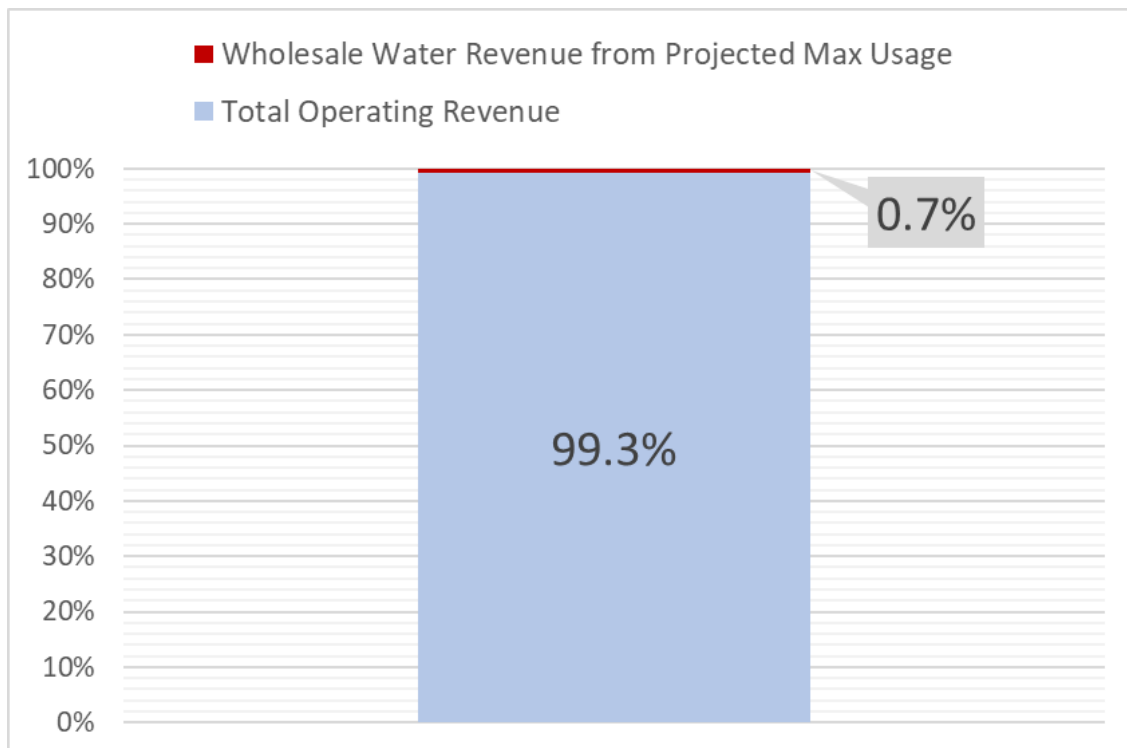
### **Equity**

A standby customer should bear the costs of reserving and using system capacity. The rate structure to recover these costs should have a fixed and variable portion. A fixed demand charge recovers the costs of providing standby or reserved capacity, and this charge should be billed regardless of the amount of water used. Once the customer consumes water on a standby basis, a consumption charge should be applied based on the amount of water purchased. The Agency staff successfully developed two components of these charges by allocating fixed costs to a fixed charge and variable costs to a volumetric rate. The fixed costs included in the fixed charge are the proportional cost of water treatment and quality, customer accounts, administrative and general, and transmission and distribution costs. Variable costs included in the variable rate calculation are water purchase, treatment, and power. The revenue generated from the fixed charge will pay for the reserved capacity and other direct costs incurred to serve the District regardless of the water use. With this rate structure, the Agency will not encounter financial losses when the District does not consume any water; thus, there is no need for retail ratepayers to cover the costs incurred by the wholesale customer.

## Revenue

Standby service is intended to be used infrequently. Therefore, such service should not be a significant source of the Agency's revenue. The Agency projects the volume of water the District purchases would not exceed 1,250 Acre Feet (AF) in any given year. For example, if District 36 purchases water for the amount of 1,250 AF in FY 2022, the Agency could generate an additional \$257,350 in revenue from the volumetric rate. Combined with the fixed charge revenue of \$292,338, the total revenue would be \$549,688 for that year. This amount represents only 0.7 percent of the Agency's total operating revenue (approximately \$80 million). If District 36 uses water over the projected maximum usage of 1,250 AF regularly, therefore generating significant revenue for the Agency, the methodology used to develop the wholesale rates should be reevaluated; however, the historical usage indicates that this may be very unlikely in the immediate future.

**Figure 2. Projected Share of Wholesale Water Revenue with 1,250 AF**



## **Impact on Retail Customers**

The standby service SCV Water provides to District 36 will not negatively impact retail customers. The system has sufficient capacity to provide the backup service without compromising the water pressure or volumes available to other customers. The expected revenue from standby rates is not significant within the context of the total operating revenue; however, these funds will allow the Agency to offset some future capital costs that would otherwise be placed on retail customers.

## **Conservation**

The recommended standby rate structure incentivizes water conservation by not including a baseline consumption level in the fixed charge. Every acre-foot of water delivered to the District will be charged under the new rate structure, sending a strong price signal. I recommend that water conservation standards be a part of the standby agreement to promote efficient water use further.