

# MEMORANDUM

**TO: UTILITIES ADVISORY COMMISSION**

**FROM: UTILITIES DEPARTMENT**

**DATE: JULY 20, 2010**

**SUBJECT: RECOMMENDATION TO DEFER ANY ACTION ON TRADING THE CITY'S EXCESS INDIVIDUAL WATER SUPPLY GUARANTEE UNTIL AT LEAST JANUARY 2011**

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## **REQUEST**

Staff requests that the Utilities Advisory Commission (UAC) recommend that Council defer any action on trading the City's excess Individual Water Supply Guarantee until after the end of 2010.

## **BACKGROUND**

Palo Alto's potable water supplies are provided by the City and County of San Francisco through the regional water system operated by the San Francisco Public Utilities Commission (SFPUC). Agencies that buy water from the SFPUC are members of the Bay Area Water Supply and Conservation Agency (BAWSCA<sup>1</sup>). On June 30, 2009, the 25-year contract between San Francisco and the BAWSCA member agencies expired. On June 1, 2009, Council approved a new Water Supply Agreement (the 2009 Contract) between San Francisco and the BAWSCA agencies (CMR: 269:09), effective July 1, 2009 through June 30, 2034.

### **Individual Supply Guarantee**

Under the old contract, San Francisco committed to providing a total of 184 million gallons per day (MGD) of water, in perpetuity, to 24 BAWSCA agencies<sup>2</sup>. Palo Alto's share of the 184 MGD, its Individual Supply Guarantee (ISG), is 17.075 MGD. The 2009 Contract reconfirms the 24 wholesale agencies' collective supply assurance of 184 MGD as well as the agencies' Individual Supply Guarantees.

In addition, under the 2009 Contract, the ISGs are permanently transferrable between BAWSCA agencies. Since Palo Alto's current and projected water usage is around 13 MGD, Palo Alto has

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<sup>1</sup> The 26 BAWSCA agencies include Alameda County Water District, California Water Service Company, Coastside County Water District, Estero Municipal Improvement District, Guadalupe Valley Municipal Improvement District, Mid-Peninsula Water District, North Coast County Water District, Purissima Hills Water District, Skyline County Water District, Stanford University, Westborough Water District, and the Cities of Brisbane, Burlingame, Daly City, East Palo Alto, Hayward, Hillsborough, Menlo Park, Milpitas, Mountain View, Palo Alto, Redwood City, San Bruno, San Jose, Santa Clara, and Sunnyvale.

<sup>2</sup> Two agencies do not have an Individual Supply Guarantee. The Cities of San Jose and Santa Clara are interruptible customers of the SFPUC and, therefore, have no ISG. The City of Hayward does not have an ISG, but it is part of the 184 MGD supply assurance.

a significant excess ISG that it could transfer to another BAWSCA agency. Money from the sale of excess ISG could be used to help fund water-related projects such as a recycled water project.

#### Interim Supply Allocation

As part of the process to gain approval for its capital program to repair and seismically upgrade the regional water system, the SFPUC opted to adopt a water supply element that included the Interim Supply *Limitation* (ISL), which restricts water deliveries from the regional system's watersheds to 265 MGD until 2018. The 2009 Contract describes how the SFPUC will implement the Interim Supply Limitation it imposed. San Francisco's share of the ISL is 81 MGD, and the BAWSCA agencies' share, *including* the cities of Santa Clara and San Jose, is 184 MGD. Specifically, the 2009 Contract states that by December 31, 2010, San Francisco will unilaterally decide how to divide the total BAWSCA agencies share of the ISL, or 184 MGD, among the 26 BAWSCA agencies, by allocating each agency an Interim Supply Allocation (ISA). The sum of all 26 agencies' ISAs will collectively total 184 MGD. The 2009 Contract also explicitly states that the Wholesale Customers do not concede the legality of the SFPUC's establishment of ISAs or imposing the Environmental Enhancement Surcharge and reserves the right to challenge in court these issues individually or collectively.

The main purpose of the Interim Supply Limitation is to encourage water conservation and to establish an environmental conditions baseline. As such, additional diversions from the Tuolumne River and Bay Area watersheds are restricted until additional environmental studies are complete (before 2018). If water usage from the regional water system exceeds the 265 MGD ISL, then an "environmental enhancement surcharge" will be levied on those agencies (including San Francisco) that exceed their ISA. Receipts from the surcharge will be used for environmental restoration or enhancement projects on San Francisco watersheds.

#### Water Shortage Allocation

For water shortages (droughts), the 2009 Contract contains a formula for how to divide available water between San Francisco and the BAWSCA agencies similar to the method agreed to in the old contract. However, because the method used to divide the water among the BAWSCA agencies expired with the old contract and there is no replacement methodology in the 2009 Contract, the BAWSCA agencies are in the process of developing one.

#### DISCUSSION

The BAWSCA agencies have been discussing these water supply issues since the 2009 Contract was approved. The water shortage allocation formula discussions have progressed to narrow down the choices, but unanimous agreement has not been achieved. Further, there is little time left for the agencies to agree on how they would propose that San Francisco establish the ISAs for each agency, since San Francisco must decide by December 31, 2010. In addition, even if the BAWSCA agencies agree on a proposed ISA formula, San Francisco is not obligated to accept any proposal from the BAWSCA agencies.

Palo Alto staff is closely engaged in these ongoing discussions and feels strongly that its perpetual ISG of 17.075 MGD must be properly recognized in any formula. Whether either or both the water shortage allocation formula decided upon by BAWSCA or the ISA set by San Francisco will be based in some way on the ISG is unclear at this time.

Meanwhile, several BAWSCA agencies have contacted Palo Alto to express interest in purchasing Palo Alto's excess ISG. One BAWSCA member, the Purissima Hills Water District

(PHWD), recently sent a letter to Palo Alto's mayor with an offer to buy 0.5 MGD of Palo Alto's ISG for \$1 million (Attachment A). The Mayor's response declining the offer is attached (Attachment B).

The value of Palo Alto's excess ISG is difficult to assess while the water shortage allocation formula and the ISA remain unknown. The value of the ISG will depend in part on whether, and to what extent, the ISG is a component of a water shortage allocation, as Palo Alto advocates. In addition, whether the ISA will be somehow based on the ISG will not be clear before December 31, 2010. Thus, the offer from PHWD was refused and staff recommends that any other offers received from PHWD or other parties be refused at this time and that no work be done to solicit any other offers to purchase any excess ISG until January 2011 at the earliest.

**ATTACHMENTS**

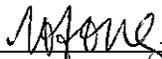
- A: May 18, 2010 letter to Mayor Burt from Purissima Hills Water District re: Principles of Agreement for Purchase of Portion of City of Palo Alto Excess SFPUC Supply Guarantee
- B: June 9, 2010 letter to Purissima Hills Water District from Mayor Burt

**PREPARED BY:**



**JANE RATCHYE**, Assistant Director, Resource Management

**APPROVED BY:**



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**VALERIE O. FONG**  
Director of Utilities



**Purissima Hills  
Water District**

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RECEIVED  
CITY MANAGER'S OFFICE



May 18, 2010

Mayor Patrick Burt  
City of Palo Alto  
1249 Harriet Street  
Palo Alto, California 94301

**Subject: Principles of Agreement for Purchase of Portion of City of Palo Alto  
Excess SFPUC Supply Guarantee**

Dear Mr. Burt:

Over the last year, the Purissima Hills Water District ("PHWD") and the City of Palo Alto ("City"), both among staff and among several elected officials, have discussed the City's interest in selling, and PHWD's interest in purchasing, a portion of the City's San Francisco Public Utilities Commission excess water supply guarantee ("Supply Guarantee").

PHWD desires to take these discussions to the next level by proposing Principles of Agreement that would establish the key business terms for the sale of a small portion of the City's Supply Guarantee to PHWD. These Principles of Agreement would serve as the foundation for a more detailed agreement that can be prepared by the attorneys for our agencies.

PHWD's proposed Principles of Agreement are attached to this letter. In short, PHWD desires to purchase 500 acre feet of the City's Supply Guarantee for a one-time purchase price of \$2,000 per acre foot, for a total purchase price of \$1,000,000. PHWD understands that 500 acre feet is approximately 12.5% of the City's excess Supply Guarantee.

We welcome the opportunity to meet with you and other representatives of the City to discuss and reach final accord on the Principles of Agreement. Please let me know when you are available to meet.

Sincerely,

Gary Waldeck  
President, Board of Directors

cc: Patrick Walter, General Manager  
Jim Keene, City Manager

Attachment

10 MAY 20 PM 2:08  
CITY CLERK'S OFFICE

**PRINCIPLES OF AGREEMENT FOR PURCHASE OF PORTION OF  
CITY OF PALO ALTO EXCESS SFPUC SUPPLY GUARANTEE**

**Amount to be Purchased:**

PHWD will purchase 500 acre feet of the City's excess SFPUC Individual Supply Guarantee.

**Purchase Price:**

PHWD will pay a one-time price of \$2,000 per acre foot for the permanent transfer of 500 acre feet of the City's Individual Supply Guarantee, for a total purchase price of \$1,000,000.

**Manner of Payment:**

PHWD will pay 100% of the purchase price within 90 days from the date of execution of agreement between PHWD and City for the permanent transfer of a portion of the Individual Supply Guarantee, or the date that the City and County of San Francisco approves the permanent transfer of this portion of the Individual Supply Guarantee, whichever occurs later.

**Time of Transfer:**

City will transfer the portion of its Individual Supply Guarantee concurrent with PHWD payment of purchase price to City.

**Recycled Water:**

PHWD will investigate in good faith the alternatives and feasibility of becoming a recycled water customer of the City of Palo Alto.

**CEQA:**

PHWD, at its sole cost, will complete the environmental review required for the permanent transfer of a portion of the City's Individual Supply Guarantee.

June 9, 2010

Gary Waldeck  
President, Board of Director's  
Purissima Hills Water District  
26375 Fremont Road  
Los Altos Hills, CA 94022

**Subject: City of Palo Alto response to Purissima Hills Water District letter of May 18<sup>th</sup> 2010, titled "Principles of Agreement for Purchase of Portion of City of Palo Alto Excess SFPUC Supply Guarantee"**

Dear President Waldeck:

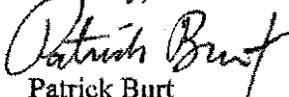
I received your letter dated May 18<sup>th</sup> regarding your interest in proposing Principles of Agreement applicable to a potential transfer of a portion of the City of Palo Alto's Individual Supply Guarantee (ISG) to the Purissima Hills Water District. Your letter outlines the broad principles and foundation of such a transaction, including pricing, volume and timeline.

The City, like Purissima Hills, receives 100% of its water supply from the San Francisco Public Utilities Commission's Hetch Hetchy system. Both of our agencies have an ISG, a contractual entitlement to water from the system that exists in perpetuity. For Palo Alto, this perpetual ISG is 17.07 million gallons of water per day. The City did historically use an amount of water equivalent to its ISG, but aggressive conservation, incentive pricing and customer awareness have resulted in dramatic water use reductions to the point that the City now consistently uses significantly less than its ISG, and is not projected to exceed its ISG in the foreseeable future.

At this time there is uncertainty surrounding the development of an allocation formula for water deliveries from San Francisco during droughts, and uncertainty in how San Francisco will establish the Interim Water Supply Limitation, which is discussed in Article Four of the Water Supply Agreement with the City and County of San Francisco, executed by both of our agencies in June 2009. The City anticipates this uncertainty will be settled within a year. At that time, the City will re-evaluate the best way to encourage an ISG trading mechanism in a manner that will create a durable market for all the BAWSCA agencies, reward agencies that have invested in conservation and water recycling, and provide a mechanism for agencies to meet their needs in a cost-effective manner. In the interim, while I appreciate your inquiry, the City is not entertaining offers to purchase any portion of its ISG.

Please feel free to contact Nicolas Procos at (650) 329-2214 if you have further questions.

Sincerely,

  
Patrick Burt  
Mayor of Palo Alto

cc: City Council Members  
Utilities Advisory Commissioners  
City Manager James Keene  
City Attorney Gary Baum

P.O. Box 10250  
Palo Alto, CA 94303  
650.329.2477  
650.328.3631 fax