August 14, 2013

Attention: Imported Water Committee

Overview of the Bay-Delta Conservation Plan Administrative Environmental Review Process and Identification of Underlying Planning Assumptions.

Background
The 1,300-square-mile Sacramento-San Joaquin Bay-Delta provides a significant portion of the water supply to an estimated 25 million Californians, including the 3.1 million residents of San Diego County. While amounts vary from year to year, the Delta was the source of approximately 22 percent of San Diego County’s water supply over the past five years. The Delta is also the largest west coast estuary in North and South America, supporting as many as 130 fish and 750 wildlife and plant species, and it is one of four major North America paths for migratory birds.

Since the 1980s, there have been a series of efforts to resolve conflicting uses in the Delta and stabilize export of water by the state and federal water projects. The Bay-Delta Conservation Plan (BDCP) is the latest joint state and federal effort to seek to resolve these conflicts and restore the Delta ecosystem to a healthy productive state. In 2009, the California Legislature adopted the Delta Reform Act (Act), which declared that existing Delta policies are not sustainable and stated the intent of the Act was to provide for the sustainable management of the Sacramento-San Joaquin Delta ecosystem, to provide for a more reliable water supply for the state, to protect and enhance the quality of water supply in the Delta, and to establish a governance structure that will direct efforts across state agencies to develop a legally enforceable Delta Plan. The Act also established the state’s policy to achieve “co-equal goals” in the Delta. The Act defines co-equal goals to mean:

“…the two goals of providing a more reliable water supply for California and protecting,restoring, and enhancing the Delta ecosystem. The coequal goals shall be achieved in a manner that protects and enhances the unique cultural, recreational, natural resource, and agricultural values of the Delta as an evolving place.”

The purpose of the BDCP is to develop a plan that would achieve the legislatively mandated co-equal goals by addressing these issues with an ecosystem-based approach through a multi-species Habitat Conservation Plan (HCP) and a Natural Communities Conservation Plan (NCCP) under the federal and state Endangered Species acts, respectively. The BDCP is intended to: identify the physical improvements and water delivery system operational requirements that will help restore fish and wildlife species in the Delta; gain regulatory agencies’ approval for necessary long-term permits for various projects and water operations; and improve water supply reliability. If successful, the operators of the State Water Project (SWP) and the federal Central Valley Project (CVP) would obtain the necessary federal and state permits to build and operate infrastructure in the Delta, including the construction and operation of a new water conveyance system over a 50-year timeframe.
The Water Authority has been a strong advocate for a sustainable Delta solution, actively engaging in Delta issues at the Metropolitan Water District (MWD) Board, the Delta Stewardship Council, within the BDCP process, and in the Legislature. The Water Authority was among the stakeholders involved in advocating for the successful passage of the 2009 comprehensive Bay-Delta bill package. The Water Authority staff has consistently pursued opportunities to bring the most contemporaneous and emerging information to the Board to ensure the Board is fully apprised of the many significant issues presented by the BDCP process. And, over the past two years, the Board has heard diverse viewpoints from a variety of Bay-Delta Stakeholders.

Discussion

This memo is the third in a series of memos to be presented to the Board, reporting on staff’s progress in assessing the four Delta fix alternatives for the ultimate goal of submitting a comment letter through the BDCP environmental review process. This memo is structured in two parts to: (1) provide the Board with a more detailed framework for understanding the formal process of evaluating environmental documents and providing public comment; and (2) provide the Board with preliminary foundational information and assumptions upon which the evaluation of BDCP alternatives will be based.

Part 1: BDCP and Public Comment on Environmental Planning Documents

Beginning in the mid-1990s, the U.S. Fish & Wildlife Service and the California Department of Fish & Game (now known as the California Department Fish & Wildlife), developed broad-based, multiple-species conservation programs to provide long-term protection and conservation of declining habitats and species that would also streamline appropriate development and growth. The state’s Natural Community Conservation Program and federal Habitat Conservation Program promote coordination and cooperation among public agencies, landowners and other interested parties to minimize natural resource conflicts, especially when activities affect endangered or potentially endangered species.

The Water Authority has utilized the NCCP/HCP process for its own projects. Recognizing the Water Authority’s diverse set of potential projects and ongoing operations and maintenance activities, the Water Authority Board directed staff to prepare an NCCP/HCP for addressing current and future endangered species impacts within the Water Authority’s service area and the extreme southwestern portion of Riverside County. A draft Environmental Impact Report/Environmental Impact Statement (EIR/EIS) was prepared. It presented a detailed analysis of potential environmental impacts associated with capital improvement projects and operations and maintenance activities. An EIR/EIS was certified by the Board in December 2010. It addresses impacts to 63 species and resulted in agreements and take permits with the wildlife agencies for a term of 50 years, providing the Water Authority with much greater certainty over future capital improvement program and operations and maintenance activities.

Although much larger in scope and complexity than the Water Authority’s NCCP/HCP, the BDCP seeks to address its issues and objectives through a similar process. As was the case with the Water Authority’s NCCP/HCP, the EIR/EIS is the foundational environmental analysis used
by the wildlife agencies and reviewed by other stakeholders to determine whether the Plan identifies and appropriately addresses the environmental impacts of the proposed activities or decisions.

In the case of the BDCP, the Plan and accompanying EIR/EIS are addressing both the construction of new facilities, joint operation of the SWP and CVP as well as much broader habitat restoration and species recovery efforts. A single joint EIR/EIS is being prepared because there are both state and federal actions involved in implementing the BDCP and the Plan must comply with both state and federal environmental laws. To provide an added level of transparency, the BDCP has released an Administrative Draft EIR/EIS (ADEIR/EIS) for stakeholders to review and potentially comment on before the official draft documents are released for formal public review and comment and response by the lead agencies under California Environmental Quality Act/National Environmental Policy Act (CEQA/NEPA). In this manner, the administrative draft is still an “internal” document that is being reviewed and commented on by responsible agencies, is subject to change, and does not take the place of the formal “public review” required under state and federal law. The administrative draft does allow reviewers a head start to understanding the proposed project and some of the underlying analysis.

Relationship of the BDCP to the EIR/EIS

The purpose of CEQA and NEPA is to provide decision makers, which includes the issuers of permits, with comprehensive information on the environmental impacts and proposed mitigation for a project. For purposes of CEQA the BDCP is a “project.” The Project includes new physical facilities for water delivery, habitat restoration, and water delivery system operational protocols. Under CEQA, the EIR describes the proposed project, identifies its significant environmental impacts, and develops reasonable mitigation measures and alternatives to eliminate or reduce such impacts. Under NEPA, an EIS describes a reasonable range of alternatives that would avoid, minimize, and mitigate adverse impacts. There is much overlap between the laws, and most agencies prepare a single document that has certain modifications to address NEPA. The balance of this discussion will focus primarily on the requirements under CEQA.

One of the most important initial tasks of an EIR is to provide a description of the proposed project and identify the “Purpose and Need” that requires that the project be considered. In the ADEIR the following summarizes the project purpose:

"DWR’s fundamental purpose in proposing the BDCP is to make physical and operational improvements to the SWP system in the Delta necessary to restore and protect ecosystem health, water supplies of the SWP and CVP south of Delta, and water quality within a stable regulatory framework, consistent with statutory and contractual obligations."

Along with the general statement of the purpose of the project are specific related objectives. The BDCP ADEIR-EIS has several stated objectives that expand on the general purpose of the project and address the need to achieve the co-equal goals of water supply reliability and
ecosystem restoration set out in the 2009 Delta Reform Act. These involve the need to obtain incidental take permits for species to be covered in the NCCP/HCP under state and federal endangered species laws, to improve the ecosystem of the Delta through the conservation and management of covered species, and by protecting, restoring, and enhancing natural communities and ecosystems. One of the more important stated objectives in achieving the co-equal goals is

"...to develop projects that restore and protect water supply and ecosystem health and reduce other stressors on the ecological functions of the Delta in a manner that creates a stable regulatory framework under the state and federal endangered species acts."

While it is required to state the purpose of a Project in the EIR and the specific objectives, it is also necessary to establish that there is a defined need that the project will meet. The ADEIR/EIS states the need for the BDCP as being driven by the necessity of addressing the following three issue areas:

**Delta Ecosystem Health and Productivity**

- Physical changes, coupled with higher water exports and declines in water quality from urban and agricultural discharges and changes in constituent dilution capacity from managed inflows and diversions have stressed the natural system and led to a decline in ecological productivity.

- Significant declines have been reported in important fish species such as Chinook salmon and Delta smelt. Fishery resource changes may be attributable to numerous factors including water management systems and facilities, water quality/chemistry alterations, and nonnative species introductions.

**Water Supply Reliability**

- Declining ability to meet defined water supply delivery volumes and water quality criteria to support water users’ beneficial needs for human consumption, manufacturing uses, recreation, and crop irrigation.

**Delta Hydrology and Water Quality**

- Changes in water inflow and outflow throughout the Delta affect the water quality within the Delta, particularly with regard to salinity. It has been estimated that seawater is pushing 3 to 15 miles farther inland since development began in the Delta 150 years ago.

- Other water constituents of concern in the Delta have been identified through ongoing regulatory, monitoring, and environmental planning processes that do not meet applicable water quality standards.
• The anticipated effects of climate change will result in elevated sea levels, altered annual and inter-annual hydrological cycles, changed salinity and water temperature regimes in and around the Delta, and accelerated shifts in species composition and distribution.

• These changes add to the difficulty of resolving the increasingly intensifying conflict between the ecological needs of a range of at-risk Delta species and natural communities and the need to provide adequate and reliable water supplies for people, communities, agriculture, and industry.

The intent of the BDCP is to develop and implement a plan that resolves the issues outlined above in a manner that meets the legislatively mandated goals of water supply reliability and ecosystem restoration. CEQA and NEPA require the analysis of alternatives that would meet most of the project objectives and purpose and need for the project while reducing the environmental impacts as well as including a No Project or No Action Alternative. The BDCP ADEIR/EIS alternative analysis begins with 15 conveyance alternatives with north of Delta diversion capacities of 3,000 cfs, 6,000 cfs, 9,000 cfs and 15,000 cfs. Those 15 alternatives were narrowed down to eight conveyance alternatives and six different operational scenarios were applied for a total of 21 alternatives that were analyzed in greater depth through a multi-level screening process.

The multi-level screening process resulted in an initial selection of the 9,000 cfs twin tunnels dual conveyance alternative as BDCP’s preferred alternative in the ADEIR/EIS and the identification of an adaptive management program (“Decision Tree”) as the means to determine the appropriate operating requirements after project construction and operation. Although identified in the preliminary environmental document as preferred, a final selection does not occur until the certification of the EIR by the state and the EIS Record of Decision filed by the federal government.

Water Authority Analysis of Official Draft EIR/EIS
As noted at previous Board meetings, once the official Draft EIR/EIS (DEIR/EIS) is released for public review and comment in October, the Water Authority staff analysis will focus on those major items that are important to the Water Authority as a recipient and purchaser of Delta exports and how they relate to the Board's adopted Bay-Delta Principles and the 2010 Urban Water Management Plan supply objectives. In previous meetings, memos, and correspondence, the Water Authority has raised issues concerning the financing and economics of implementing the BDCP, the viability of potential yield under the BDCP preferred alternative, and whether to consider alternatives that factor components complementary to conveyance improvements and operational changes within the Delta to address water supply needs. The public comment on the DEIR/EIS is related to the environmental impacts and the related supporting analyses, including identification of significant impacts, the adequacy of the alternatives studied, and mitigation measures proposed.
Although a DEIR/EIS’s project description must contain a general description of its technical, economic, and environmental characteristics. Financing, cost effectiveness and economic benefit are generally not “environmental” issues absent evidence of unique economic impacts giving rise to potential environmental effects. Thus, while staff will review economic issues as appropriate to such things as project description, mitigation measures, feasible alternatives and the like. Financing and business considerations relevant to full development of Board position on a specific BDCP alternative will be evaluated separately. For example, project finance options are addressed in Chapter 8 of the BDCP document and the Water Authority has already sent some comment letters on BDCP Chapter 8.

In developing it DEIR/EIS comment letter, staff will evaluate how the DEIR/EIS addresses three major areas of concern: water supply reliability; Delta ecosystem health and productivity; and Delta hydrology and water quality. All three areas are inextricably linked to the reliable delivery of Delta exports to the Water Authority and bear on achievement of the Board's Bay-Delta Principles and 2010 Urban Water Management Plan supply objectives.

Economic issues directly related to environmental issues may be addressed in comments on the DEIR/EIS, but additionally staff will prepare draft comments on the BDCP planning documents themselves. The comments on the planning documents can address the financial, business and policy issues that are outside the scope of those implicating environmental impacts. Staff anticipates returning to the Board in September with the initial results of the analysis and at the regular October meeting following release of the official public review DEIR/EIS with the key concepts to include in a response to comments letter under the DEIR/EIS and the BDCP planning documents.

Neither CEQA nor NEPA considers the financing or business issues identified by the Water Authority other than in broad terms as to cost effectiveness and economic benefit to project proponents. However, those financing and business issues are a significant consideration for a Board position regarding implementation of a specific BDCP alternative and are all being thoroughly analyzed through the review process. Finance issues are addressed in the BDCP document in Chapter 8. The Water Authority has already addressed some of these finance issues outside the formal DEIR/EIS public comment process in comment letters on BDCP Chapter 8. Additional comment letters may be needed.

**Part 2: Identification of Underlying Assumptions for BDCP Alternatives Evaluation**

**Baseline Assumptions**
A significant foundational aspect of evaluating BDCP alternatives is identifying and understanding the underlying assumptions and baselines that are being utilized as the basis for analysis. It is only through an identification of those underlying assumptions and baselines that an evaluation of incremental or marginal benefits and costs can be achieved.
As Water Authority staff engage in the technical analysis of BDCP alternatives, it is important to note that the issue of assumptions and baselines from which analysis will occur is not a simple matter. Since the BDCP document (the HCP/NCCP) has different legal and regulatory standards and requirements than the EIR/EIS for the BDCP, different assumptions and baselines were utilized for the two documents. BDCP explained the rationale for using different baselines as follows:

- EIR/EIS alternatives are analyzed from a perspective of avoiding or substantially lessening impacts to the human environment on a wide variety of issue areas.
- HCP/NCCP alternative actions are evaluated from a perspective of avoiding or lessening “take” of covered fish and wildlife.
- Cost-benefit analyses of alternatives are not required nor described in the EIR/EIS, while cost-benefit is a significant issue in the context of making important policy decisions as part of a HCP/NCCP.

The important issue concerning the use of a baseline in any analysis is that it accurately reflects expected conditions absent the effects of the project or activity being proposed. Environmental documents have tended to analyze a baseline from current conditions at the time of the development of the EIR or EIS with some minor modifications for expected changes. Recent case law, including the decision to uphold the Quantification Settlement Agreement (QSA) EIR and a similar California Supreme Court decision issued just this month, have allowed the use of a projected future trending baseline if it is based on substantive scientific evidence. Over the coming months, staff will continue to investigate this issue further and will assess the basis and implications, if any, of multiple assumptions and baselines as the analysis proceeds.

**Preliminary Demand Analysis**

To the extent demand is evaluated in the BDCP, it is being used to determine the economic benefits of the BDCP and other “take” alternatives (Appendix 9.A). The report in Appendix 9.A examines the economic implications for the state’s urban and agricultural water agencies from a range of potential water supply outcomes of BDCP. In regard to urban demands, the analysis compares forecasted water demands with available local and imported water supplies, along with storage reserves, to determine the potential shortages that could exist under an existing conveyance scenario and the take alternatives, which include the BDCP proposed action. The main goal of the analysis is to measure and value the urban water shortages forecasted to occur under the existing conveyance scenarios that would be avoided under each take alternative. As part of the economic benefit analysis, the difference in shortages between the existing conveyance scenario (continued sole reliance on through-Delta conveyance and south Delta pumping) and the take alternatives are considered, rather than the absolute shortage that would result from each take alternative. The analysis incorporates supply and demand data on the following agencies: 26 MWD water agencies along with Alameda County, Antelope Valley-East Kern, Castaic Lake, City of Santa Maria, Mojave, Palmdale, San Bernardino Valley, San Gorgonio, Santa Clara Valley Water District and Zone 7. The BDCP ADEIR/EIS chapter on
growth inducement and other indirect effects includes an appendix (Appendix 30B) that also describes the projected water demand and water supply profiles for a selection of these agencies.

For MWD, the BDCP utilized data included in its 2010 Integrated Resources Plan (IRP) and MWD’s 2010 Regional Urban Water Management Plan (RUWMP). During 2012, the Water Authority commissioned a report comparing MWD’s 2010 RUWMP data with MWD member agencies’ urban water management plans and found discrepancies in MWD demand forecasts. The Water Authority’s report demonstrated that demands shown in MWD’s RUWMP were higher than member agencies’ cumulative demand forecasts because several planned local projects (such as the Carlsbad Seawater Desalination Project) were not included in MWD’s RUWMP. The exclusion of several planned local projects from MWD’s RUWMP artificially inflated MWD’s imported water demand. It is noted that although the BDCP appendix 30B referred to MWD’s 2010 RUWMP, the BDCP also represents that some of the data has been updated to reflect the recently updated Southern California Association of Governments report and more specifically, the Carlsbad Seawater Desalination Project is now included in those demand forecasts. In staff’s analysis of Delta fix options, how the BDCP reflects water demand data and how that enters into the economic benefits analysis and the alternatives analysis in DEIR/EIS will be further investigated.

Preliminary Economic Benefits and Financing Analysis
State and federal regulations for the development of an HCP and NCCP require the assurance of “adequate funding” by the conservation plan applicant to implement the variety of conservation projects and efforts that might be embodied within a conservation plan. Within the BDCP administrative draft is Chapter 8 – Implementation Costs and Funding Sources – that is intended to provide details of the BDCP funding strategy to satisfy the “adequate funding” requirement. There are three specific substantive issue areas that are lacking necessary discussion within Chapter 8:

- Enforceable financial commitments by contractors’ member agencies or units. State water contractors that are wholesale water agencies should demonstrate that their customers – the member agencies or units that purchase their water and provide their revenue – have take-or-pay contracts or other enforceable commitments to pay the fixed costs of the project commensurate with the term of the BDCP obligation.

- Effects of “step up” provisions. It is important to analyze the possible effects of “step up” provisions – those bond pledges that may require other BDCP participants to assume the obligations of defaulting participants – on MWD and other participants in the BDCP.

- Contractors’ taxing authority to fund new conveyance facilities contemplated in BDCP. A careful legal analysis should be undertaken especially of MWD taxing authority within the BDCP due diligence process, to examine the feasibility and appropriateness of using property taxes as additional back-up security for project debt.
On July 30, the Water Authority communicated some of its concerns over shortcomings in the Chapter 8 financing discussion to Dr. Jerry Meral (see Attachment 1). That letter raised similar concerns the Water Authority raised in an August 28, 2012 letter to Dr. Meral.

On August 5, the draft *Bay Delta Conservation Plan Statewide Economic Impact Report* by Dr. David Sunding of The Brattle Group was released for public review. The economic impact information and analysis will be part of the Water Authority staff’s review of the overall financing plans and the cost-benefit analysis of the BDCP alternatives. This information will be reviewed to determine whether an appropriate business case can be made for any of the alternatives under evaluation by the Water Authority. Dr. Meral and Dr. Sunding plan to attend the Board’s September 12 workshop. Dr. Sunding will be part of a panel focusing on economic issues at the workshop.

The economic benefit analysis contained in the BDCP administrative draft assesses the value of the BDCP preferred alternative on water shortage avoidance, water quality improvement, and seismic risk reduction. The value assessed on water shortage avoidance is dependent on contractors’ demand for Delta exports. In that regard, the Water Authority staff will assess the demand projections used in the BDCP and investigate the frequency and magnitude of water shortage avoided under the BDCP assumptions. In the Water Authority’s evaluation, those results will be weighed against the options to increase local supply development and water efficiency programs, in terms of costs and the practicability and feasibility of implementing such alternative solutions.

**Preliminary Water Supply Yield Analysis**

The BDCP evaluates species take alternatives on impacts to covered fish and wildlife species by the varying scale of water conveyance facilities, changes in project operations, and the amount of natural community restoration. Based on these variations in factors, a range of projected water yields are estimated. For the BDCP preferred alternative, two sets of potential water yields – high and low outflows – are estimated to provide a potential range of water yields resulting from project implementation. However, water supply yield remains subject to the “Decision Tree” adaptive management process, and therefore actual yield results cannot be assured until the facility is built and placed into operation. In staff’s evaluation, this uncertainty will be included as part of the risk assessment.

**Limitation of Review**

It is important to note that two of the four alternatives that staff is evaluating and comparing within its due diligence analysis – the NRDC Portfolio Based Alternative and the Delta Vision Foundation’s BDCP Plus Strategy – are not considered by BDCP within the context of its environmental review process beyond the evaluation of the proposed 3,000 cfs conveyance starting point of the NRDC proposal and the 6,000 cfs conveyance capacity that best approximates the strategy proposed by the Delta Vision Foundation. Both options identified a storage component, which proponents believe could improve yield, but was not modeled in the BDCP analysis. Aside from the analysis of conveyance capacity and associated restoration
acreage the other components of these proposals have not gone through the extensive analyses as have the BDCP preferred alternative and the No Action alternative.

At the August 8, 2013 Special meeting of the Imported Water Committee, Board members expressed a desire to conduct “apple to apples” comparisons between the different alternatives that include comparable information for all alternatives on costs, facilities and other basic data needs. Because neither the NRDC Portfolio Based proposal nor the Delta Vision Foundation BDCP Plus option are fully developed alternatives for all their components, staff will not be able to conduct that type of comprehensive comparative analysis. What staff proposes is to use the detailed information on the smaller conveyance capacities associated with the two options that are analyzed in the BDCP planning documents and DEIR/EIS. Using that data, a detailed comparison can be made of the relative benefits and risks of each conveyance alternative as to yield, cost, benefits and ability to achieve the co-equal goals. This analysis will also allow staff to determine how these different alternatives address the Board’s Bay-Delta Policy Principles.

The added components included in the NRDC Portfolio Based proposal and Delta Vision Foundation BDCP Plus option will be analyzed in terms of their potential to mitigate risks addressed in the BDCP preferred alternative or identified in the BDCP No Action Alternative. Staff’s analysis will focus on how much (or not) the value of additional storage will bring to the overall value of the export facility, as well as the value of additional local water supply development to the overall reliability of the region’s supply outlook. Staff will also assess the risks associated with implementation of the outside of delta components of these two alternatives and the requirements for additional data and project descriptions.

This two step approach to the analysis will allow staff to determine how these different alternatives address the Board’s Bay-Delta Policy Principles and meet the supply reliability goals expressed in the 2010 Urban Water Management Plan.

**Next Steps**

Staff will continue to implement its multidisciplinary evaluation and analysis of the four alternatives. Based on the schedule outlined below, a special Board meeting featuring BDCP economics analyses by Dr. David Sunding (The Brattle Group) and Dr. Jeffrey Michael (University of the Pacific) will be held on September 12, and the staff will continue to develop its technical analysis, including responses to policy questions, for each of the four alternatives under review, for the September 26 Board meeting.
<table>
<thead>
<tr>
<th>Meeting</th>
<th>Imported Water Committee/Board Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>7/25/2013</td>
<td>Provide input on scope of proposed Water Authority analysis of BDCP alternatives; Provide input on policy questions to be addressed</td>
</tr>
<tr>
<td>8/8/2013 Special Meeting</td>
<td>Overview of Bay–Delta and proposals for Delta fix, including description of alternatives</td>
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<tr>
<td>8/22/2013</td>
<td>Review of technical analysis – demand assumptions; alternative project yield assumptions; projected costs</td>
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<tr>
<td>9/12/2013 Special Meeting</td>
<td>BDCP economic study on cost–benefit of BDCP preferred alternative</td>
</tr>
<tr>
<td>9/26/2013</td>
<td>Review of technical analysis (cont.), including responses to policy questions</td>
</tr>
<tr>
<td>10/10/2013 Special Meeting</td>
<td>Summary of technical analysis: Comparison of alternatives with Delta Policy Principles</td>
</tr>
<tr>
<td>10/24/2013</td>
<td>Information: Identify areas of concern; potential CEQA–NEPA comment letter</td>
</tr>
<tr>
<td>11/21/2013</td>
<td>Action: EIR/EIS comment letter; consider adopting position on BDCP alternative(s)</td>
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Attachment 1: July 30, 2013 letter from General Manager to Deputy Secretary Meral
July 30, 2013

Dr. Gerald Meral  
Deputy Secretary  
California Natural Resources Agency  
1416 Ninth Street, Suite 1311  
Sacramento, CA 95814  

Dear Jerry:

Thank you for the efforts that you, your state and federal agency colleagues, and the Administration have made to bring the BDCP to the point where it stands today. We appreciate the opportunity that the release of an administrative draft of the BDCP affords us to provide comments and questions that should be addressed in the next draft. This letter is a follow-up to the Water Authority’s previous correspondence on BDCP Chapter 8, and conversations we have had with you over the past year.

Like many other stakeholders, the San Diego County Water Authority anticipated the May 29 release of the final chapters of the administrative draft of the BDCP document and believed, based upon earlier representations, it would address the questions and concerns the Water Authority has raised over the past several years over project financing. In particular, we were anxious to review the new draft of Chapter 8 in light of the correspondence we sent you 11 months ago (attached), in which we raised a series of BDCP financing issues and concerns. Our subsequent conversations led us to believe these concerns would be addressed in the most current iteration of Chapter 8. Instead, and disappointingly, Chapter 8 begins with this jarring admission:

"Details of the financing... are still being determined through on-going discussion between the state and federal governments and between the government, the state and federal water contractors and other interests."

After reviewing the newly-revised Chapter 8 of the BDCP administrative draft, seven years into the BDCP planning process, and nearly a year after commenting on the prior draft, the most critical financing issues confronting the BDCP have yet to be addressed.

As we shared with you previously, potential participants in the BDCP must have sufficiently detailed information to evaluate the cost-benefit (or feasibility) of participating in the project. We recently heard David Sunding report to the Metropolitan Water District of Southern California’s (MWD) Board of Directors that a cost-benefit analysis has been produced for all urban and agricultural water contractors, and that it includes an urban cost-benefit analysis for all MWD member agencies. Would you please send a copy of the complete report to me in advance of Dr. Sunding’s Sept. 12 appearance before our Board’s Imported Water Committee?
As we have consistently stated, the Water Authority believes that any BDCP financing plan must include enforceable agreements to pay for the project, not only from state water contractors directly, but also from the member agencies or units that provide their revenues. The costs are far too high to simply rely on the hope that the contractors’ water sales will be adequate over the long-term to pay the project’s costs.

As the largest customer of the largest state water contractor – MWD – the Water Authority’s member agency ratepayers have a great deal at stake in the BDCP process and its financing plan, its risks and contingencies. The Water Authority must be able to assess that the preferred alternative advocated by the BDCP program will provide sufficient benefits to be affordable for our member agency ratepayers. We also must ensure that our ratepayers are not at risk of paying BDCP costs associated with the water supplies of other MWD member agencies or other state or federal water contractors. The Water Authority is already in litigation with MWD over how it allocates its current State Water Project costs.

The Water Authority is concerned that future progress of the BDCP and efforts to resolve seemingly intractable conflicts in the Delta will falter if those expected to be participants in the BDCP are not able to evaluate the cost-benefit of the various alternatives or reasonably limit the risk that their ratepayers will be expected to assume. In this context, we renew our request that our comments and concerns raised in our August 28, 2012 correspondence regarding Chapter 8 of the BDCP administrative draft – Implementation Costs and Funding Sources – be addressed in the next draft.

**Comments**

In our August 28, 2012 correspondence, we identified three specific issue areas as lacking necessary discussion within Chapter 8:

- State water contractors that are wholesale water agencies should demonstrate that their customers – the member agencies or units that purchase their water and provide their revenue – have take-or-pay contracts or other enforceable, long-term commitments to pay the fixed costs of the project commensurate with the term of the BDCP obligation.

- It is important to analyze the possible effects of “step up” provisions – those bond pledges that may require other BDCP participants to assume the obligations of defaulting participants – on MWD and other participants in the BDCP.

- A careful legal analysis should be undertaken of MWD taxing authority within the BDCP due diligence process, to examine the feasibility and appropriateness of relying upon property taxes as additional back-up security for project debt.

**Take-Or-Pay Contracts/Enforceable Commitments**

As we have previously pointed out in discussions with you, MWD – which, as the largest state water contracting agency, is the foundation for financing the BDCP project – has been struggling over the past several years to pay its current fixed costs, let alone a substantially larger new cost associated with the BDCP. More than 80 percent of MWD’s costs are fixed – however, less than 20 percent of MWD’s revenues are paid from fixed charges. Conversely, more than 80 percent of MWD’s revenues are from water sales – a variable revenue source – and those sales have
declined by 30 percent since 2007. Furthermore, MWD’s member agencies are not required to purchase any water from MWD. The variability of water sales – and thus uncertain future water sales revenues – coupled with Southern California water agencies’ current and future planned actions to implement the State’s policy to reduce reliance on water supplies imported from the Delta, creates significant uncertainty regarding long-term financing of BDCP obligations. This should be a major concern for the State of California, whose full faith and credit will be expected to back up the financing of the project. And yet, Chapter 8 makes no mention of this material, foundational risk to BDCP financing.

The Water Authority believes that, at a minimum, state water contractors that are wholesale water agencies must demonstrate that their customers have take-or-pay contracts or other enforceable long-term commitments to pay the fixed costs of the BDCP project corresponding to the term of the BDCP obligation. The Water Authority continues to be prepared to make such a commitment to MWD as long as the Water Authority gets the water supplies in return for its payments. We also believe that the willingness to make a financial commitment to a Delta solution will largely determine the demand for Delta water supply, and therefore help inform the best sizing for the conveyance facility. It would not be in the state’s best interest to construct a facility only to have it stranded because no one is willing to pay for it, or hoped-for water sales necessary to pay for it do not materialize.

“Step-Up” Provisions
Existing State Water Project contracts contain provisions under which non-defaulting contractors can be assessed to cover payments not made by defaulting contractors, up to 25 percent of the defaulting contractors’ obligations. Additionally, the East Branch Extension of MWD’s State Water Project contract has a provision obligating MWD to cover default by any and all other participants. These State Water Project contract stipulations are known as “step-up” provisions.

We are informed that bond underwriters for the BDCP project are expected to require a “step-up” provision by which each BDCP participant in BDCP-related bonds pledges to assume the obligations of defaulting participants. In fact, the newly-released Chapter 8, at Section 8.10.1.1.1 (page 8-81) provides that:

“Existing water contracts would need to be amended to include the new costs of the BDCP assigned to the state water contractors and the repayment schedule.”

Since “step-up” provisions are already embodied within, and apply to, MWD’s State Water Project contract, it would appear that such provisions would apply to the “new costs of the BDCP assigned to the state water contractors.” Given those “step-up” provision obligations, we renew our request that Chapter 8 fully analyze the possible financial and economic effects of the “step-up” provisions on MWD and the other participants in the BDCP.

Property Taxes
Some have suggested that property taxes may be contemplated as back-up security for BDCP payment obligations of individual state water contractors. There are very clear and significant limitations in MWD’s existing taxing authority under the provisions of the MWD Act:

- The Act limits MWD’s ability to levy taxes to pay its State Water Project obligations.
MWD is limited to levying taxes for "the composite amount required to pay (1) the principal and interest on general obligation bonded indebtedness of the district and (2) that portion of the district's payment obligation under [the SWP contract] which is reasonably allocable, as determined by the district, to the repayment by the state of principal and interest on [SWP bonds] as of [January 1, 1985] and used to finance construction of facilities for the benefit of the district."

- Although the Act contains override ability in the event of a fiscal crisis, as determined by the MWD board, the override is limited to only one year at a time. In such an event, the State of California and bondholders would be relying upon an annual vote of MWD’s Board of Directors in which it “...finds that a tax in excess of these restrictions is essential to the fiscal integrity of the district....”

- It is unclear whether changes to the limitations provided under the MWD Act would require voter approval and/or new legislation. Chapter 8 should address and answer these questions.

Given these limitations and uncertainties, it is difficult to consider MWD’s existing taxing authority as a meaningful back-up security for BDCP payment obligations. It is also highly questionable whether the financing of BDCP can be – or should be – backed by taxing authority that was authorized by voters decades ago, when the program was much different than is being discussed today. A careful legal analysis of MWD taxing authority should be included in the BDCP due diligence process if taxes are going to be relied upon as additional back-up security for BDCP project debt. The newly-released version of Chapter 8 is silent on this issue.

Based on the assurances that you previously provided to the Water Authority, we expected that the full consideration and analysis of the issues we have raised would be integrated into the Chapter 8 analysis and conclusions. And yet, the current version of Chapter 8 of the BDCP administrative draft does not comprehensively or adequately conduct due diligence on all of the facts and circumstances described in this letter and our previous correspondence. We remain concerned that a potential cascading collapse of funding could occur if the proper due diligence is not undertaken in a timely manner.

We appreciate the opportunity to provide comments on the newly-released Chapter 8 of the BDCP administrative draft. We remain committed to working with you and all parties to evaluate, address, and resolve these critical financing issues.

Sincerely,

Maureen A. Stapleton
General Manager

Attachment: August 28, 2012 letter
August 28, 2012

Dr. Gerald Meral
Deputy Secretary
California Natural Resources Agency
1416 Ninth Street, Suite 1311
Sacramento, CA 95814

Dear Jerry:

Thank you for visiting with us on Wednesday. We enjoyed our discussion, and appreciate the information you shared on the progress of the Bay-Delta Conservation Plan. We very much appreciate the efforts by you, Secretary Laird, Governor Brown, Secretary Salazar and all of the state and federal agencies in bringing the BDCP to this point.

We promised to send you the Water Authority's comments on BDCP Chapter 8. We understand that work is under way to produce a new draft of Chapter 8. It is our hope that the issues outlined below will be considered and addressed.

Introduction
The San Diego County Water Authority is a wholesale water agency providing a safe and reliable water supply to 24 public agencies in San Diego County, supporting our region's $186 billion economy and the quality of life of 3.1 million Californians. Highly dependent on imported water supplies, the Water Authority has historically and consistently been a strong advocate for the Delta and for the co-equal goals of providing a more reliable water supply for California, while protecting, restoring and enhancing the Delta ecosystem. The Water Authority's board of directors reaffirmed this longstanding support at its February 2012 board meeting. The board also adopted an updated set of policy principles relating to the Bay-Delta outlining the critical issues that must be resolved in the BDCP process; a copy of these Policy Principles is enclosed.

Chief among the Water Authority's concerns is the need to define the various components of the financing plan for the BDCP and the recently announced decision-tree concept in a manner that allows potential participants to evaluate the cost-benefit (or feasibility) of participating in the project. We believe the financing plan must include enforceable agreements to pay for the project, not only from state water contractors directly, but from the member agencies or units.
that provide their revenues. The costs are simply too great to rely on the hope that there will be enough water purchasers over the long-term to pay the project's costs.

As the largest customer of the largest state water contractor – the Metropolitan Water District of Southern California (MWD) – the Water Authority's ratepayers have a great deal at stake in the BDCP process and its financing plan. The Water Authority must be able to assess not only that the project will provide sufficient benefits to be affordable by our ratepayers, but also that they are not at risk of paying BDCP costs associated with the water supplies of other MWD member agencies or state contractors. The Water Authority is already in litigation with MWD over how it allocates its current State Water Project costs.

The Water Authority is concerned that all of the progress that has been made in bringing the BDCP to this point will be stymied, and that the BDCP will fail if participants are not able to evaluate the cost-benefit of the project or reasonably limit the risk their ratepayers are being asked to assume. It is in this light that we offer the following brief comments on the administrative draft of Chapter 8 – *Implementation Costs and Funding Sources*.

**Comments**

As the largest state water contractor, MWD is the foundation for financing the project. And yet, MWD itself has been struggling over the past several years to pay its current fixed costs – let alone a substantially larger cost associated with the BDCP. The reason is simple: more than 80 percent of MWD's costs are fixed while less than 20 percent of its revenues are paid from fixed charges. More than 80 percent of MWD’s revenues come from water sales. Yet, MWD’s member agencies are not required to purchase any water from MWD. With its member agencies unwilling to sign take-or-pay contracts or make any other firm financial commitments to MWD to cover its fixed obligations, the agency remains heavily dependent on revenues from variable water sales. MWD’s water sales have declined approximately 30 percent since 2008, with its firm sales declining to less than 1.3 million acre-feet in fiscal year 2012. MWD’s member agencies – including the Water Authority – have also experienced significant reductions in sales. A direct consequence of these declining sales is sharply higher imported water rates that have made additional local water supply investments economically competitive. As a consequence, MWD’s member agencies – and their sub-agencies – are doing what they have been asked to do over the past 20 years: reducing reliance on water supplies imported from the Delta.
We are concerned that the BDCP will become the kind of “big ticket project” that MWD board members vocally and enthusiastically support – at the same time their agencies are unwilling to make enforceable commitments to pay for the project.

A final note on the subject of risk: because the project is anticipated to be financed through project revenues, we are informed that bond underwriters are expected to require a “step up” provision by which each BDCP participant in BDCP-related bonds pledges to assume the obligations of defaulting participants. The current draft of Chapter 8 is silent on this issue, yet it is conceivable that some of the BDCP participants may default, which would cause remaining participants, including MWD, to assume a greater portion of the debt. It is important that Chapter 8 analyze the possible effects of the “step up” provisions on MWD and the other participants in the BDCP.

Some have suggested that property taxes may provide the ultimate security for BDCP payment obligations of individual contractors. Putting aside the question whether property taxes levied under the authorization of the Burns-Porter Act may be used to pay for new projects contemplated by the BDCP, it is important to remember that MWD’s taxing authority is further limited by the provisions of the MWD Act. Although the Act contains override ability in the event of a fiscal crisis as determined by the MWD board (one year at a time3), it effectively limits MWD’s ability to levy taxes to pay its SWP obligations. It is also unclear whether changes to this limit would require voter approval. Thus, a careful legal analysis of MWD taxing authority should be included in the BDCP due diligence process if taxes are contemplated as additional back-up security for project debt.

To effectively evaluate the finances available for the BDCP, the drafters of Chapter 8 need to conduct comprehensive due diligence on all of the facts and

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1 Under Section 50(h) of MWD’s current State Water Project contract, non-defaulting contractors can be assessed to cover payments not made by defaulting contractors, up to 25 percent of the payment not made. Under Section 49(l) of its East Branch Extension of the State Water Project contract, MWD is obligated to cover a default by any and all other participants.

2 Section 124.5 of the Metropolitan Water District Act limits MWD’s property tax levy to “the composite amount required to pay (1) the principal and interest on general obligation bonded indebtedness of the district and (2) that portion of the district’s payment obligation under [the SWP contract] which is reasonably allocable, as determined by the district, to the repayment by the state of principal and interest on [SWP bonds] as of [January 1, 1985] and used to finance construction of facilities for the benefit of the district.”

3 In such an event, the State of California would be relying upon an annual vote of MWD’s Board of Directors in which it “...finds that a tax in excess of these restrictions is essential to the fiscal integrity of the district....”
circumstances described in this letter. Without such due diligence, the BDCP faces a potential cascading collapse of funding. At a minimum, state water contractors that are wholesale water agencies must demonstrate that their customers – the member agencies or units that buy their water and provide their revenues – have take-or-pay contracts or other enforceable commitments to pay the fixed costs of the project commensurate with the term of the BDCP obligation. The Water Authority continues to stand ready to make such a commitment to MWD that provides benefits commensurate with its payments.

Ultimately, the full faith and credit of the State of California will back up the bonds issued to build the conveyance project. Failure to secure enforceable financial commitments from the member agencies or units of water wholesale contractors could place all of California at significant risk of having tens of billions of dollars of new outstanding debt without sufficient water contractor payments to cover the debt service. This is why all California taxpayers have a stake in ensuring that there is a solid foundation and financing plan for the BDCP going forward.

Thank you again for providing the opportunity to comment on the administrative draft of Chapter 8 of the BDCP. We are committed to working with you and all parties to address and resolve these issues.

Sincerely,

Maureen A. Stapleton
General Manager

Enclosure: Water Authority Bay-Delta Policy Principles
San Diego County Water Authority

February 15, 2012

Attention: Imported Water Committee

Adopt Delta Policy Principles. (Action)

Staff recommendation
Adopt Delta Policy Principles to guide staff in evaluating Bay-Delta initiatives and the Water Authority’s advocacy to ensure a successful implementation of a Delta solution.

Alternatives
1. Modify one or more draft principles.
2. Do not adopt Delta Policy Principles.

Fiscal impact
None.

Background
The Sacramento-San Joaquin Bay Delta is an important water supply source for Southern California. Metropolitan Water District (MWD) purchases water from the Department of Water Resources through its State Water Project (SWP) contract. MWD is the SWP’s largest customer, providing more than 50 percent of its revenues. As such, MWD is the principle source of revenue under the current SWP as it will be for any proposed Bay Delta solution. As the largest steady purchaser of MWD water, the Water Authority has a vital interest in assuring that any Bay Delta solution is financially sustainable. The Water Authority has advocated for a number of changes in the MWD rate structure, including securing take-or-pay contracts with its member agencies or other firm commitments to pay the fixed costs of a Delta conveyance project.

Discussion
The Water Authority has been a strong advocate for a sustainable Bay Delta solution. The Water Authority actively engages in Bay Delta issues at the MWD board and other forums including the State Capitol, where it lobbied for passage of the 2009 comprehensive Bay Delta bill package. The 2009 bill package approved as state policy the co-equal status of restoring the Delta ecosystem and creating a more reliable water supply for California. Recently, the Water Authority held two Bay-Delta workshops receiving input from stakeholders on their views of the issues and a Bay Delta solution. The Water Authority also participates directly on three Bay Delta Conservation Plan (BDCP) working groups on Conveyance, Governance and Finance.

The Water Authority has consistently advocated for a “right-size” solution in the Delta that is also supported by a broad range of stakeholders in order to reduce challenges to implementation. A central point of the Water Authority’s advocacy position in determining the “right size” of a Bay
Delta solution is clear commitments to pay through take-or-pay contracts or legal equivalent to pay the fixed costs of a project.

The Delta Policy Principles will help guide staff as they evaluate the BDCP and other projects and actions relating to the Bay Delta solution. Draft principles were presented to this committee for review last month; the attached recommended principles reflect comments received on the prior draft.

Prepared by: Debbie S. Discar-Espe, Senior Water Resources Specialist
Reviewed by: Jeff Volberg, Government Relations Manager
Amy I. Chen, MWD Program Chief
Approved by: Dennis A. Cushman, Assistant General Manager

Attachment: Delta Policy Principles
San Diego County Water Authority
Delta Policy Principles

The San Diego County Water Authority Board of Directors supports a Bay Delta solution that will meet the co-equal goals and provide San Diego County with a reliable, high-quality supply of affordable, imported water consistent with the Water Authority’s Urban Water Management Plan and Regional Facilities Optimization and Master Plan. The adopted policy principles will guide staff in evaluating projects and actions concerning the Bay-Delta.

Water Supply Reliability
- Continue to support the co-equal goals of water supply reliability and environmental restoration embodied in the 2009 Delta bill package.
- Support deliberative processes that are designed to ensure a meaningful dialogue with all stakeholders in order to reduce future conflicts and challenges to implementation of a Bay Delta solution.
- Provide regulatory certainty and predictable supplies to help meet California’s water needs in the long-term.
- Encourage a Bay Delta solution that acknowledges, integrates and supports the development of water resources at the local level including water use efficiency, seawater and brackish water desalination, groundwater storage and conjunctive use, and recycled water including direct and indirect potable reuse.
- Improve the ability of water-users to divert water from the Delta during wet periods, when impacts on fish and ecosystem are lower and water quality is higher.
- Encourage the development of a statewide water transfer market that will improve water management.
- Support improved coordination of Central Valley Project and State Water Project (SWP) operations.

Ecosystem Restoration
- Restore the Bay-Delta ecosystem consistent with the requirements established under the state Natural Community Conservation Plan and the federal Habitat Conservation Plan, taking into account all factors that have degraded Bay-Delta habitat and wildlife.
- Work with all stakeholders to ensure a meaningful dialogue and that ecosystem restoration issues are addressed in an open and transparent process.

Finance and Funding
- Encourage and support a Bay Delta solution and facilities that are cost-effective when compared with other water supply development options for meeting Southern California’s water needs.
- Require the total cost of any Bay Delta solution be identified before financing and funding decisions are made. The total cost must include the cost of facilities, mitigation and required or negotiated ecosystem restoration.
- Allocate costs of the Bay-Delta solution to stakeholders in proportion to benefits they receive.
• Seek and support independent financial analyses of Bay-Delta solution including the ability of all parties to pay their proportional costs.

• Require a firm commitment and funding stream by all parties to pay for the fixed costs associated with the proportional benefits they will receive from a Bay Delta solution, through take-or-pay contracts or legal equivalent.

• Condition financial support on provisions allowing access to any water conveyance or storage facilities that are included in the Bay Delta solution.

• Support the use of public funds to support specific projects and actions with identified costs that protect and restore the environment and provide broad-based public benefits.

• Oppose water user fees to fund ecosystem restoration and other public purpose, non-water-supply improvements in the Delta that benefit the public at large.

Facilities

• Require independent technical analysis of proposed key elements of the Bay-Delta solution, including forecasting future urban and agricultural demands and size and cost of any proposed conveyance facility, to ensure the solution realistically matches statewide needs.

• Support “right-sized” facilities to match firm commitments to pay for the Bay Delta solution.

• Allow access to all SWP facilities to facilitate water transfers.

Governance

• Support continued state ownership and operation of the SWP as a public resource.

• Support improved efficiency and transparency of all SWP operations.

• Oppose any transfer of operational control of the SWP or any of its facilities to MWD, the State Water Project Contractors, Central Valley Project Contractors, the State and Federal Contractors Water Agency, any entity comprised of MWD or other water project contractors, or any other special interest group.