

January 20, 2021

Attention: Imported Water Committee

Bay-Delta Update (Presentation)

Purpose

This memo provides an update on various activities that may impact State Water Project (SWP) yield and the proposed Bay-Delta tunnel project.

Executive Summary

- The Water Authority Board updated its Bay-Delta Policy Principles in July 2019 and, among other things, conditionally supported a single-tunnel Bay-Delta fix so long as the project costs are properly allocated as supply charges.
- The California Department of Water Resources (DWR) is developing environmental and technical documents for the proposed \$15.9 billion single-tunnel Bay-Delta fix. DWR expects to complete the environmental review in 2023.
- Last month, the Metropolitan Water District of Southern California (MWD) Board approved funding 47.2 percent of tunnel planning costs. MWD will consider whether to participate in the project, and at what level, once DWR completes the environmental review.
- DWR and the SWP contractors reached an Agreement in Principle (AIP) for a future SWP supply contract amendment to account for and allocate the costs and benefits of the tunnel in April 2020. Contractors' proportionate share of costs and benefits were populated into the AIP as they approved funding agreements for planning costs.
- In April 2020, the courts upheld the authority of the Delta Stewardship Council and the validity of the Delta Plan, meaning that certain actions must demonstrate consistency with the plan and the State's coequal goals of water supply reliability and ecosystem restoration. This consistency requirement may have consequences for the timeline and implementation of the tunnel project and future regulations for reduced reliance on the Bay-Delta.
- MWD is updating its 2020 Integrated Water Resources Plan (IRP), which will evaluate the best path forward for MWD to meet future demand, including the extent of the region's reliance on the Bay-Delta.
- In addition, MWD will consider executing a SWP supply contract amendment for enhanced Water Management Tools to facilitate transfers and exchanges in February.

Background

At its July 2019 Board meeting, the Water Authority supported Governor Newsom's water resilience portfolio approach, including a single-tunnel Bay-Delta project (project) and integrated multi-benefit solutions that address water supply availability and environmental health.¹ The support for the project is conditioned upon costs being allocated to supply charges. This conditional support aims to ensure

¹ The July 2019 Bay-Delta & Project Policy Principles are found here: <https://www.sdcwa.org/sites/default/files/Bay-Delta%20Project%20Policy%20Principles%20072519.pdf>

costs of the tunnel align with the project's purpose to stabilize water supplies. In line with this purpose, DWR has historically characterized similar projects (i.e., the Peripheral Canal) as supply projects. If the tunnel is mischaracterized as transportation and costs are allocated accordingly, the Water Authority's ratepayers would be disproportionately impacted because the Water Authority is the only agency that relies on MWD to transport large quantities of its own independent Colorado River supplies. Furthermore, an allocation to transportation charges would disincentivize water agencies from implementing other projects that would support the State's policy to reduce reliance on the Bay-Delta and facilitate water transfers.

MWD's participation in a Bay-Delta fix would be a major investment that should be considered in terms of its anticipated demands, other resource projects, and financing strategies. The tunnel environmental and technical studies and cost allocation discussions, as well as MWD's 2020 IRP update and rate review process, will inform the MWD Board's decision about this investment.

Discussion

Bay-Delta Project

In January 2020, DWR released a Notice of Preparation for an Environmental Impact Report for the project to satisfy requirements of the California Environmental Quality Act.² The project would result in a "dual conveyance" system by creating a second method for SWP water diversion in the Bay-Delta to complement existing facilities. The proposed tunnel would divert and transfer up to 6,000 cubic feet per second of water from north of the Bay-Delta to existing SWP facilities (and potentially the Central Valley Project (CVP), although CVP participation is not being considered at this time) for exports. DWR is evaluating both a central and eastern tunnel alignment, as well as an alternative that would connect the eastern option to the existing SWP Bethany Reservoir to eliminate the need for certain proposed facilities and reduce impacts in the south Bay-Delta.

DWR will prepare environmental and technical documentation over the next several years until it adopts a final Environmental Impact Report, expected in mid-2023, and secures permits by 2024. DWR will also develop initial operating criteria in its draft environmental documents and adopt final operating criteria following completion of the environmental processes. This schedule aligns with that of the Army Corps of Engineers, which will publish an Environmental Impact Statement for the project to satisfy National Environmental Policy Act requirements.

The preliminary cost estimate for the project stands at \$15.9 billion in undiscounted dollars.³ The cost for the first tunnel of the now-defunct twin-tunnel California WaterFix (WaterFix) project was estimated at \$11.7 billion in 2020 dollars⁴—over 35 percent less. DWR reports the assumptions used in the new project's estimate are different than those used for WaterFix and include a larger

² The Notice of Preparation is found here: https://water.ca.gov/-/media/DWR-Website/Web-Pages/Programs/Delta-Conveyance/Delta_Conveyance_Project_NOP_20200115_508.pdf?la=en&hash=74B80DAAE5B9C4BC2EB0619B6A252011F72D1087

³ The Delta Conveyance Design and Construction Authority's Preliminary Cost Assessment for the tunnel is found here: <https://www.dcdca.org/wp-content/uploads/2020/09/2020-08-20-DCABoardPkgVF-1.pdf>

⁴ *Economic Analysis of Stage I of the California WaterFix* by Dr. David Sunding in February 2018 states the cost estimate for the first tunnel was \$11.09 billion in undiscounted 2017 dollars: https://www.waterboards.ca.gov/waterrights/water_issues/programs/bay_delta/california_waterfix/exhibits/docs/CDWA%20et%20a1/part2rebuttal/sdwa_317.pdf

contingency. In August 2020, DWR filed a validation suit to seek judicial affirmation of its authority to issue revenue bonds to finance the proposed project. A number of Bay-Delta water agencies and environmental groups are challenging the validation, arguing it is unlawful because DWR has not yet defined a final project or completed the public environmental review and permitting processes.

Allocation of Tunnel Costs

From July 2019 to April 2020, DWR and the SWP contractors negotiated a proposed amendment to the SWP supply contracts to account for and allocate the costs and benefits of the project between participating agencies using their SWP Table A allocation as a starting point.⁵ The resulting AIP allows contractors to opt out of their entire Agricultural or Municipal & Industrial Table A share of project costs in exchange for opting out of the associated benefits. Contractors can also elect to assume additional costs, and correlating benefits, beyond their proportional Table A share. Though the AIP was reached in April 2020, SWP contractors did not indicate their expected “contracted proportionate shares” until later that year. DWR and the contractors will populate the AIP with these cost and benefit allocation factors to finalize the document.⁶ Contract language for the proposed amendments is under development and will not be considered for approval until after the completion of the project’s environmental review.

Because the five north-of-Delta contractors assert the project will not provide them benefits, their 2.79 percent share of costs (based on Table A) will be spread proportionally among the project participants. Six south-of-Delta SWP contractors elected to opt out of the project, amounting to another 3.67 percent of Table A supplies, which will be absorbed by other participants besides MWD.

On December 8, the MWD Board approved funding up to 47.2 percent (\$160.8 million) of the \$340.7 million project planning costs, representing its own Table A and proportional share of North-of-Delta contractors’ Table A shares. In line with this percentage, the Board authorized funding up to \$58.9 million over the upcoming two-year planning period, and staff can extend the funding agreement’s term without amendment “if appropriate board authorization exists” (i.e., via the adoption of fiscal year 2023 and 2024 budget appropriation). MWD’s fiscal year 2021 and 2022 project planning budget is \$50 million. In December 2019, DWR returned about \$34 million in advanced funding for WaterFix to MWD. While it was not explicitly stated in the budget document, staff reported it will use these returned funds to fill the projected \$8.9 million budget gap for single-tunnel planning costs.

Kern County Water Agency is the only SWP contractor with both an Agricultural and Municipal & Industrial Table A allocation, and thus was able to both opt out of its entire Agricultural share *and* elect to take on additional costs and benefits on top of its Municipal & Industrial share. In November 2020, it opted for a participation level of about 11 percent (thus leaving its remaining 13 percent Table A share unfunded). In the months leading up to approval of the funding agreement, MWD staff indicated it would recommend that MWD fund Kern County Water Agency’s unfunded share, which would bring MWD’s total participation to 60.2 percent. However, due to concerns from some Board members about “subsidizing agriculture” and commitments from DWR that the project could move

⁵ For more information about the negotiations, see the memo *Bay-Delta Update* starting on page 208 of the Water Authority’s April 2020 Board packet found here: <https://www.sdcwa.org/meetings-and-documents>

⁶ Due to the roughly 13 percent unsubscribed project share discussed below, allocation factors will not be finalized until after environmental review is complete and agencies make final decisions about their project participation.

forward without MWD taking on the additional share, MWD staff ultimately recommended funding 47.2 percent of the project. In December, DWR reported that participating agencies' contributions would be sufficient to fund planning costs for the next two years based on projected cash flow.⁷ To close any remaining funding gap over the final two years, DWR says it may 1) use the budgeted contingency funds, 2) use other SWP revenue, or 3) make minor spending reductions. Any SWP revenue used to fund tunnel costs will be recovered through bonds that will be repaid by project participants.

Project Joint Powers Authorities

The Delta Conveyance Finance Authority, a Joint Powers Authority originally formed by participating contractors (working with DWR) to issue bonds to finance WaterFix, continues to meet on an as-needed basis to complete administrative actions since the shift in direction to a single-tunnel project. The Delta Conveyance Design and Construction Authority (DCA), another Joint Powers Authority originally formed by participating contractors to undertake WaterFix design and construction activities, is assisting DWR with engineering planning activities to support the single tunnel's environmental review process. Last month, at the same time it approved funding project planning, the MWD Board also approved changes to the DCA's governance structure that dilute MWD's representation on that board of directors. While MWD formerly occupied two seats on the five-member board, the DCA board was expanded to seven members with MWD occupying only one seat. MWD's large financial commitment will only be considered in DCA votes if certain financial decisions are being *reconsidered*, and approval requires 70 percent support based on "contracted proportionate share" of participation in the project.

Since the project was modified to a single tunnel in 2019, the DCA was funded temporarily by DWR using undefined SWP revenues until SWP contractors signed on to participate and fund planning work. In October 2020, the DCA and DWR approved an agreement amendment to increase DWR's "initial contribution" to the DCA from \$33.8 million to \$43.2 million. The DCA spent these funds, but as agencies executed funding agreements with DWR to contribute toward planning costs in late-2020, the DCA will repay DWR for its initial \$43.2 million investment.

Delta Plan

The Sacramento-San Joaquin Delta Reform Act of 2009 (Delta Reform Act) established the Delta Stewardship Council (Council) and directed it to create and oversee implementation of a long-term, legally-enforceable management plan to achieve the co-equal goals of improving water supply reliability and protecting and restoring the Bay-Delta ecosystem. The resulting Delta Plan, adopted in 2013, requires agencies that plan "covered actions" in the Bay-Delta to file a certification of consistency with the Delta Plan through the Council. Any person claiming the action is not consistent with the Delta Plan can appeal the certification, in which case the Council may require an amended certification from the agency before it can move forward with the action; the amended certification may also be appealed.

Several groups, including MWD, filed lawsuits over the Delta Plan challenging issues such as the Council's appeal process and its policy that a covered action cannot be certified unless: (1) each water

⁷ See DWR Director's December 3, 2020 letter to the SWP Contractors: <https://mwdprograms.sdcwa.org/wp-content/uploads/2020-12-03-DWR-ltr-to-SWC-re-SWC-Participating-in-DCP.pdf>

supplier, including retail agencies, that will receive water from the action completes an urban or agricultural water management plan that identifies local projects that will reduce their reliance on the Bay-Delta, (2) the management plan quantifies how much the projects will reduce their reliance on the Bay-Delta, and (3) the suppliers implement the management plan and report on their progress.

In 2016, a court rejected these claims but ruled that the Delta Plan was invalid because it lacked legally enforceable, measurable goals for reduced reliance and did not adequately “promote” policies and recommendations regarding conveyance or storage systems in the Bay-Delta. In April 2020, an appellate court reversed this ruling and held that the Council has broad discretion to adopt regulations as needed to carry out its responsibilities in the Delta Reform Act, including adopting measurable reduced-reliance goals, and has jurisdiction to regulate water rights related to covered actions in the Bay-Delta. The California Supreme Court declined to take up an appeal, so the appellate decision stands. The appellate court ruling may cause the Bay-Delta project to face considerable delays if its certification of consistency is repeatedly appealed. Furthermore, if MWD or other SWP contractors and their sub-agencies do not adopt water management plans that meet the Delta Plan’s requirements to demonstrate reduced reliance on the Bay-Delta, the Council may prevent the tunnel from being certified and moving forward.

MWD’s Long-Term Planning Strategy

DWR’s financial statements show it expects to borrow about \$3 billion for repair and replacement projects for its existing facilities, and that it will expend hundreds of millions of dollars in the near-term, and more in the long-term, to address subsidence along the California Aqueduct.⁸ These expenses will add to the pressure on water rates from any Bay-Delta fix. In line with this, the Water Authority advocates that MWD make funding and implementation decisions about large supply projects, including the tunnel, as part of a comprehensive long-term planning strategy that contemplates financial implications, including the impact of member agencies’ reduced demand for MWD water. The Water Authority Delegates advocate that MWD update its policies surrounding the Bay-Delta (adopted between 2004 and 2007) and create a comprehensive, long-term Bay-Delta management plan. This plan should: (1) embody a portfolio approach to water management by coordinating MWD’s efforts to protect SWP supplies with its member agencies and regional activities, including MWD’s potential first local supply project (the Regional Recycled Water Program); and (2) describe how this portfolio approach will assist MWD in reducing demand on the Bay-Delta and, thus, complying with state policy.

Voluntary Agreements

The State Water Resources Control Board (State Board) has been working to update its Water Quality Control Plan for the San Francisco Bay/Sacramento-San Joaquin Delta Estuary (Bay-Delta Plan) since 2009 to address southern Bay-Delta salinity and San Joaquin River flows. In 2018, the State Board issued a framework to address water quality concerns in the Sacramento River/Delta based on unimpaired flows, which would reduce water exports. Since then, the California Natural Resources Agency has been simultaneously negotiating voluntary agreements with water agencies and non-governmental organizations to update and implement the goals of the Bay-Delta Plan

⁸ In December 2019, MWD’s General Manager told the Water Authority Board that preliminary estimates for long-term projects to address subsidence total \$3 to \$5 billion: https://www.sdcwa.org/sites/default/files/2016-12/Board/2019_Audio/2019_12_19SpecialBoardAudio.mp3

without relying solely on regulation of unimpaired flows. In February 2020, Governor Newsom released an updated framework for the voluntary agreements, which called for over \$5 billion in funding from the federal and state governments and water users. The governor's framework included 815,000 to 912,000 acre-feet of new flows for the environment, over 60,000 acres of habitat restoration, a science program, and a goal to double salmon populations by 2050. Some non-governmental organizations criticized the voluntary agreement framework for double counting habitat restoration and providing fewer flows than those proposed in the State Board's updated framework.

In February 2020, following a memorandum from then-President Trump, the CVP adopted new operating rules meant to increase operational flexibility, which gave rise to several lawsuits. The State alleged that the federal government's rules reduce protections for listed species and were adopted without adequate consideration of environmental impacts. Diverging from its historic practice, the State adopted its own operating rules in March 2020. Some environmental organizations claim that both sets of rules insufficiently protect at-risk species, while SWP contractors claim the state rules shift some of the CVP's mitigation burden to the SWP contractors.⁹ The voluntary agreement negotiations paused shortly after the framework was released due to the State's litigation against the federal government over the federal rules. Under President Biden, it is possible some litigation may be withdrawn if his Administration proposes rules more aligned with the State's, and voluntary agreement negotiations may resume.

State Water Project Contracts

Apart from the AIP for a future SWP contract amendment for the proposed tunnel, DWR has circulated a Water Supply Contract Extension Amendment and a Contract Amendment for Water Management Tools and Actions. The Contract Extension amendment—which would extend the terms of the SWP supply contracts from 2035 to 2085—has been executed by 22 of 27 contractors, including MWD, and DWR is awaiting court validation before implementation. The Water Management Tools amendment will enhance SWP contractors' ability to transfer and exchange supplies in the face of growing supply uncertainties and will be effective when 24 of the 27 SWP contractors execute the amendment. If 24 contractors do not execute the Water Management Tools amendment by February 28, 2021, DWR can determine whether to implement the amendment with those who have executed. The MWD Board will consider approving the amendment in February.

Next Steps

Water Authority staff will continue to monitor activities that affect the Bay-Delta project and SWP yields and report back to the Board with additional updates as necessary.

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⁹ See *Bay-Delta Update* starting on page 208 of the Water Authority's April 2020 Board packet.