



# San Diego County Water Authority

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July 30, 2013

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

**MEMBER AGENCIES**

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fallbrook Public Utility District
- Helix Water District
- Lakeside Water District
- Olivenhain Municipal Water District
- Otay Water District
- Padre Dam Municipal Water District
- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Ramona Municipal Water District
- Rincon del Diablo Municipal Water District
- San Dieguito Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuma Municipal Water District

**OTHER REPRESENTATIVE**

- County of San Diego

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?

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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 in to 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



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August 28, 2012

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**Dr. Gerald Meral**  
**Deputy Secretary**  
**California Natural Resources Agency**  
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**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.**

#### **OTHER REPRESENTATIVE**

- County of San Diego

**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**

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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.<sup>1</sup> 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.<sup>2</sup> Although the Act contains override ability in the event of a fiscal crisis as determined by the MWD board (one year at a time<sup>3</sup>), 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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<sup>1</sup> 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(i) of its East Branch Extension of the State Water Project contract, MWD is obligated to cover a default by any and all other participants.

<sup>2</sup> 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.”

<sup>3</sup> 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....”

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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,

A handwritten signature in black ink, appearing to read "Maureen A. Stapleton". The signature is fluid and cursive, with the first name being the most prominent.

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

**Imported Water Committee**  
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**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 L. 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.**