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Vacant, *Treasurer*
Lawrence Bauman, Executive Director

1521 "I" Street
Sacramento, CA 95814
Tele: 916-448-1638
Fax: 916-446-1063
Email:
Larry: lbauman@cvpwater.org

June 4, 2014

Ms. Brooke Miller-Levy, Project Manager
Central Valley Project Cost Allocation Study
Bureau of Reclamation, MP-730
2800 Cottage Way
Sacramento, CA 95825

Subject: Central Valley Project (CVP) Water Association (CVPWA) Comments on Reclamation's CVP Cost Allocation Study (CAS) Findings and Recommendations Table

Dear Ms. Miller-Levy:

In addition to the general comments made May 30, 2014 to Reclamation's Regional Director (copy attached), CVPWA offers the following specific comments on the subject Findings and Recommendation Table.

1. Cost Allocation vs. Cost Recovery. Cost allocation factors developed via the CAS are used to assign both CVP construction and operation and maintenance (O&M) costs among authorized project purposes. Therefore, the allocation of O&M costs should also be identified as a primary purpose of this study.

   While cost allocation is technically separate from cost recovery, the reimbursable costs must be aligned, both in terms of those representing future benefits as well as future water and power deliveries, to ensure proper rates for recovery of reimbursable costs.

2. Interim vs. Final Cost Allocation. CVPWA supports the decision to make the current cost allocation study the final cost allocation for CVP facilities subject to the 2030 repayment requirements.

3. Cost Allocation Methodology. CVPWA concurs that the Separable Costs Remaining Benefits (SCRB) cost allocation methodology should be used for the updated CVP cost allocation.

4. Facilities Included. CVPWA concurs with the facilities to be included in the study but questions why Western Area Power Administration facilities are excluded. Also, CVPWA would like to know if the costs identified and to be utilized, by facility, in the study will be adjusted for applicable additions, replacements, retirements etc. that have occurred to those facilities over time. If they haven't, CVPWA suggest that they be used as this would get them back to the original/base cost of those facilities and not the total costs to date and subject to reimbursement.

CVPWA also suggests that Reclamation add "DMC/CA Aqueduct Intertie" to list of facilities, in 2nd paragraph, not subject to the 2030 repayment obligation.

5. Interest Rate. CVPWA concurs with the interest rate to be used in the cost allocation study.

6. Base Year. CVPWA disagrees with using 2010 as the base year. For consistency purposes, CVPWA believes that the base year should be the same as used in all CVP cost allocations to date, that is, the first year after completion of the cost allocation study. CVPWA would like Reclamation to explain why they want to deviate from past practice.

7. Period of Analysis. CVPWA concurs with the use of 100 years beyond the initial date of service as the period of analysis for the cost allocation study.

8. Initial 50-Year Analysis and Historic Benefits. CVPWA concurs with Northern California Power Agency's (NCPA) prior comments on why the use of historical benefits is unacceptable. In addition, CVPWA does not support Reclamation's proposal to evaluate benefits for 50 years initially to see they would exceed the Single Purpose Alternative as it conflicts with the period of analysis shown in #7 above and contradicts the SCRB cost allocation methodology.

9. Benefit Analysis (Basis). Reclamation's Directives and Standards for Project Cost Allocations (PEC 01-02) measure benefits from a national perspective as opposed to a local one. CVPWA concurs with NCPA in that this is contrary to how Reclamation collects revenue and, should national benefits be greater than California benefits, CVP contractors should not have to pay for benefits that flow to others. Conversely, CVP contractors should not pay less than the actual benefits they receive if national benefits are lower than California benefits.

10. Water Year Types. Reclamation plans on developing a range of benefits based on critical, dry, below normal, above normal and wet water year types based on the CalSim2 modeling. This seems like a costly exercise and could Reclamation achieve similar results using an average water year. If so, has Reclamation already created an average year scenario that could be used for this purpose?

11. Hydrology Model. CVPWA concurs on use of the CalSim2 model for hydrology purposes. However, we reserve the right to further comment on this when the outcomes of this modelling become known and available for review.

12. Water Supply Deliveries. CVPWA concurs with the use of CalSim2 model for estimating future water deliveries. However, CVPWA would like to know Reclamation's source for historic delivery data to make sure that historic water deliveries are based on actual deliveries and not on paid for water (original water service contracts had a provision in them requiring a contractor to pay for water whether they actually took it or not). Here again, we reserve the right to further comment on this when the outcomes of this modelling become known and available for review.

13. Capital Cost Evaluation and Facility Sizing. At Reclamation's May 2, 2014 public meeting there were indicators that the technical teams cost estimating preference would be to use "Indexing" over "Re-pricing" even though they stated numerous times that a final decision hasn't been made. Some of those indicators were as follows:

    - Reclamation is moving forward to index all Single Purpose (SP) and Multipurpose (MP) facilities within the next nine months.

- All SP facilities will have capitalized cost indexed to 2010 by May 15, 2014.

- All MP facilities should have capitalized cost indexed to 2010 by February 2015 (per follow up discussion with Reclamation staff on May 15, 2014).

- Re-pricing, on the other hand, can be affected by: (1) construction and product improvements; and (2) technology can dramatically alter unit prices.

- Re-pricing is also much more labor intensive and would add approximately one year to the completion of this study (2017 instead of 2016). Reclamation has repeatedly stated that the completion of this study would be in 2016.

Then on May 7, 2014, Reclamation released an Issue Paper on this subject with a recommendation by the technical team to use the cost indexing method, specifically BCI, for the CVP CAS. As noted in prior CVPWA comments, there is great interest in expediting the cost allocation study process. To do so, CVPWA recommended that Reclamation, where ever possible, do the following: (1) identify the issues; (2) identify the pros and cons; (3) provide its recommended approach and assumptions used; and (4) invite stakeholder comments. This practice would streamline the stakeholder input process by limiting the range of feasible alternatives and approaches. And, CVPWA believes that it should have been used in the May 2, 2014 public meeting.

CVPWA, based on the results of Reclamation's evaluation of building Shasta Dam in 2010 dollars via indexing or re-pricing and the significant increase in time that re-pricing will take as noted in their issue paper, concurs with the technical team's recommendation to use the cost indexing methodology. However, as also noted in response #4 above, CVPWA suggests that the capitalized facility costs taken from Schedule No. 1 of the CVP Financial Statements numbers be adjusted for additions, replacements, retirements etc. that may have occurred to those facilities over time. Doing this would get the facility back to its original/base cost and not the total costs to date and subject to reimbursement.

14. <u>Capital Costs: Types of Costs</u>. CVPWA concurs with Reclamations findings here, but agrees with NCPA that Restoration Fund costs paid by water and power are Specific Costs that need to be included as Separable Costs in the SCRB cost allocation. As such, Restoration Fund payments need to be deducted from the justifiable expenditure to determine the remaining justifiable expenditure to be used to allocate joint costs.

15. <u>Facility Sizing</u>. CVPWA concurs with the method proposed by Reclamation for use in facility sizing.

16. <u>Inclusion of New Melones Project</u>. CVPWA concurs with Reclamation's legal advisor's recommendation that Reclamation assume responsibility for determining the cost allocation factors for the New Melones Unit.

17. <u>Trinity River: Key Assumptions</u>. CVPWA concurs with NCPA's comments on the material presented at the March 28, 2014 meeting (their item #9) and shown as follows: *"Reclamation states that flood control and navigation are not authorized for the Trinity River Division and that costs will not be allocated to those purposes. Yet Reclamation operates the division for flood control and makes water releases from Trinity Dam for that purpose. If flood control is not an authorized purpose Reclamation should not operate the Trinity division to meet flood control*

objectives. This is exactly why project cost allocations are updated – to more accurately reflect current and future project operations and the associated benefits. Trinity flood control benefits need be evaluated in this study and appropriate costs allocated to that purpose. Reclamation should report to Congress when this study is finished that Trinity is operated for flood control and costs will be allocated to flood control in accordance with the benefits provided."

18. Flood Control Benefits Methodology. CVPWA concurs with NCPA's comments on the material presented at the March 28, 2014 meeting (their item #10) and shown as follows: *"Reclamation states that the benefit analyses for each reservoir was completed by indexing historic damage prevented values forward to the base year. This is contrary to slides 26 and 27 of the October 21, 2011 PowerPoint presentation which shows that future benefits, not historical benefits, were used to develop the CVP flood control benefit analysis."*

19. Navigation. CVPWA concurs with NCPA's comments on the material presented at the March 28, 2014 meeting (their item #11) and shown as follows: *"Reclamation states that future navigational benefits are no longer being provided but historical benefits will be considered. Further, Reclamation states there is no need to develop a SPA cost because the CVP no longer provides navigation benefits. If the SPA is zero, however, the allocated cost to navigation will be zero because SCRB uses the lesser of the benefits or the SPA to determine the justifiable expenditure. This is yet another example of why attempting to use historic benefits is incompatible with the SCRB cost allocation process and cost recovery."*

20. Power Benefits Methodology. CVPWA concurs with NCPA's comments on the material presented at the March 28, 2014 meeting (their item #12) and shown as follows: *"Reclamation needs to use today's energy reality to value power benefits in this cost allocation. The actual power benefits are already known because of the California Independent System Operator (CAISO) market. The CAISO provides hourly and sub-hourly market rates for every generation product and several publications are available that project these values into the future. The CAISO market rates also include a valuation for greenhouse gas emissions and reflect the projected use of renewable generation in California's future. Regarding the sub-allocation of power costs between project use and commercial power, Reclamation needs to develop a proposal for that procedure."*

21. Fish & Wildlife Benefits Methodology. CVPWA concurs with NCPA's comments on the material presented at the March 28, 2014 meeting (their item #14) and shown as follows: *"The operation of the CVP has changed dramatically since the late 1980's to provide benefits for fish and wildlife, including incapacitating the Red Bluff Diversion Dam, meeting various water quality standards, and releasing significantly more water from CVP dams for flow and temperature control. NCPA recommends that Reclamation utilize the methodology in the Shasta Dam Water Resource Investigation to develop fish and wildlife benefits for this cost allocation."*

22. Water Quality Benefits. CVPWA concurs with NCPA's comments on the material presented at the March 28, 2014 meeting (their item #15) and shown as follows: *"Reclamation quotes Public Law 99-546 as stating "the costs for providing water for salinity control and for complying with State water quality standards above D-1485 shall be non-reimbursable" and then paradoxically states it is researching whether it was the intent of Congress that added costs of complying with water quality standards higher than D-1485 is non-reimbursable. It is very clear the language of Public Law 99-546 states those additional releases shall be non-reimbursable."*

23. Recreation Benefits. CVPWA concurs with NCPA's comments on the material presented at the March 28, 2014 meeting (their item #16) and shown as follows: *"Reclamation states that it*

anticipates that no joint costs will be allocated to the recreation purpose for any multi-purpose CVP facility. The Shasta Dam Water Resource Investigation shows that the recreation benefits from the existing Shasta Dam are close to $100 million per year, which is similar to the power benefits generated from Shasta Dam on an annual basis. Further, large recreation use at Folsom Dam and to a lesser extent at Trinity and New Melones occurs on an annual basis. In addition Reclamation makes water releases on certain days to enhance the American River recreation. Since the project is operated and produces significant recreation benefits not originally anticipated when the facilities were authorized, Reclamation needs to include recreation benefits in the cost allocation analysis, report the benefits to Congress, state that the CVP will allocate costs to recreation commensurate with the benefits now being produced at CVP facilities."

CVPWA looks forward to its continued participating with Reclamation throughout this important process and, as noted previously, reserves the right to further comment on the currently proposed processes when the outcomes have become known and are available for review. If you have any questions regarding these comments, please contact me at 916-448-1638 or lbauman@cvpwater.org.

Sincerely,

Lawrence J. Bauman

Lawrence J. Bauman, Executive Director
Central Valley Project Water Association

Attachment

cc: via e-mail only

Ms. Brenda Bryant
Assistant Regional Director for Business Service
Bureau of Reclamation, MP-110
2800 Cottage Way
Sacramento, CA 95825

Mr. Jason Phillips
Deputy Regional Director
Bureau of Reclamation, MP-115
2800 Cottage Way
Sacramento, CA 95825

Ms. Michelle Denning
Regional Planning Officer
Bureau of Reclamation, MP-700
2800 Cottage Way
Sacramento, CA 95825

1521 "I" Street
Sacramento, CA 95814
Tele: 916-448-1638
Fax: 916-446-1063
Email:
Larry: lbauman@cvpwater.org

May 30, 2014

Mr. David Murillo
Mid-Pacific Regional Director
Bureau of Reclamation, MP-100
2800 Cottage Way
Sacramento, CA 95825

Subject: Central Valley Project Water Association (CVPWA) Concerns Regarding the Direction of the Current Central Valley Project (CVP) Cost Allocation Study (CAS)

Dear Mr. Murillo:

The CVPWA has a long history of working with Reclamation to collaboratively resolve complex, and occasionally contentious issues, affecting CVP water and power contractors (Contractors). It is in this spirit that we write to you today to express and share our concerns regarding the ongoing CVP CAS.

The CVPWA is aware of and recognizes the complexities of the CVP and the associated difficulties of undertaking and completing the CVP CAS. We understand that there is neither a perfect way to do this study nor a project in all of Reclamation to model this study after and that there will be many questions about the assumptions made along the way. The CVP is unique in that its construction period stretches from the 1930's to current and the project still hasn't been declared complete. As such, it is CVPWA's hope that common sense and business sense will play vital roles in determining an outcome that is fair and equitable to all concerns.

As you know, the last detailed CVP cost allocation study was completed in 1970 with a minor update in 1975. Since the late 1980's when water service contracts were starting to be renewed, construction and O&M costs have been allocated and annual water rates calculated based on the percentages developed in 1975. Since that 1975 update there have been legislative and operational changes affecting the benefits of the CVP. As a result, the current cost allocation is not a fair and equitable reflection of the current benefits among each of the project purposes.

It has been CVPWA's belief that when the CVP cost allocation study was updated, it would be done in the same manner as prior CVP cost allocations. That is, Reclamation would use the Separable Costs Remaining Benefits (SCRB) cost allocation methodology and the same practices as used in all prior CVP costs allocations to do the new study (which CVPWA would support).

Unfortunately, we are seeing telltale signs of changes in Reclamation practices that are unexpected, disconcerting and seemingly unjustified to the Contractors. The following are some examples:

1. In all prior CVP cost allocation studies Reclamation has used a 100 year benefit analysis period, using the lesser of the benefits or the Single Purpose Alternative (SPA) to determine the justifiable expenditure for each project purpose. Reclamation is proposing to evaluate benefits for only 50 years to see if initial benefits exceed SPA. This directly contradicts the SCRB cost allocation methodology.

2. In all prior CVP cost allocation studies Reclamation has used a prospective basis when determining project benefits. They are now proposing using a historical benefit analysis which would, among other things: (a) inappropriately weigh the allocation of costs to project benefits provided in the past; (b) diminutively value operational changes that have occurred in the last 25 years; (c) not be aligned with current and future operations of the project; (d) be disconnected from future water and power rate setting; and (e) slant the SCRB method so that the SPA becomes the justifiable expenditure for every project purpose.

3. In all prior CVP cost allocations, the "base year" was determined to the first year after the completion of the cost allocation study. Reclamation has stated that 2010 will be the base year in the current study.

4. Reclamation appears to be leaning toward retroactive application of the current CVP CAS results to past construction and operation and maintenance costs. It's CVPWA's belief that this decision would neither make good common nor business sense. Since the late 1980's and in accordance with CVP Irrigation and M&I water ratesetting policies, Reclamation has been keeping individual contractor accountings and calculating annual water rates by contractor based on those results. To make retroactive adjustments some 26 years later, without advance notification, is just not the right thing to do. And while the Reclamation Manual Directives and Standards may state that results will be applied retroactively, they are basing that on the assumption that all Reclamation projects are generally the same. The CVP is an anomaly and should be exempt from this practice.

Thank you for your time and consideration of our comments and concerns on this important process. If you have any questions regarding these comments, please contact me at 916-448-1638 or lbauman@cvpwater.org.

Sincerely,

Lawrence J. Bauman

Lawrence J. Bauman, Executive Director
Central Valley Project Water Association

cc:

Mr. Jason Phillips
Deputy Regional Director
Bureau of Reclamation, MP-115
2800 Cottage Way
Sacramento, CA 95825

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