United States Department of the Interior

APR 16 1998

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Region 1
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U.S. Bureau of Reclamation
Mid-Pacific Region
2800 Cottage Way
Sacramento CA 95825-1898

Subject: **Final CVPIA Administrative Proposal on Contracting Policies**

Dear Interested Party:

In September 1995, the Department of the Interior (Interior) invited the public to identify their concerns regarding implementation of the Central Valley Project Improvement Act (CVPIA). To facilitate public input and discussion, Interior representatives held a series of public meetings between September 1995 and April 1996. During these meetings, 12 major areas of concern were identified, and individuals volunteered to form work teams and discuss the specific issues pertaining to those areas. In April 1996, Interior committed to the preparation of an Administrative Proposal to address the principal issues raised by stakeholders during the public forum and work team meetings.

To that end, Interior circulated two draft proposals regarding contracting issues on July 1, 1998: *CVPIA Administrative Proposal, Contracting Policies--Part A Discretionary v. Mandatory CVPIA Contract Renewals* and *CVPIA Administrative Proposal, Contracting Policies--Part B, Contracting Issues*. Written comments were received from nine parties. The enclosed final Administrative Proposal on Contracting Policies combines Parts A and B of the draft proposals and reflects key comments received as well as previously raised concerns.

Copies of this final proposal can be accessed on the Mid-Pacific Region's home page at **http:/www.mp.usbr.gov** or can be obtained by calling Ms. Alisha Sterud at 916/978-5195 or TDD 916/978-5608.

Sincerely,

Michael J. Spear
Regional Director
U.S. Fish and Wildlife Service
Region 1

Roger K. Patterson
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Enclosure

INTRODUCTION

In September 1995, the Department of the Interior (Interior) invited the State of California and the public to identify any concerns they had regarding implementation of the Central Valley Project Improvement Act (Title XXXIV of Public Law 102-575) ("CVPIA"). To facilitate public input and discussion, representatives of Interior held a series of public meetings between September 1995 and April 1996. During these meetings, 12 major areas of concern were identified[1] and individuals volunteered to form work teams and discuss the specific issues pertaining to those areas.

In April 1996, Interior committed to prepare "Administrative Proposals" to address the principal issues raised by stakeholders during the public forum and work team meetings. To that end, on July 1, 1996, Interior circulated two draft proposals regarding contracting issues arising from Section 3404: *CVPIA Administrative Proposal, Contracting Policies--Part A Discretionary v. Mandatory CVPIA Contract Renewals* and *CVPIA Administrative Proposal, Contracting Policies--Part B, CVPIA Contracting Issues*. Written comments on the draft proposals were received from 9 parties. This Administrative Proposal on the Contracting Policies combines Part A and Part B of the draft proposals and has been revised to reflect the key comments received on the draft proposals as well as previously raised concerns. Responses to specific comments are provided in Appendix A.

BACKGROUND

The Central Valley Project Improvement Act (CVPIA), Section 3404, "Limitation on Contracting and Contract Reform," addresses a range of issues related to the contracting policies of the Bureau of Reclamation (Reclamation) for water supplies from the Central Valley Project (CVP). Sections 3404(a) and (b) address the issuance of new contracts; Section 3404© addresses the renewal of existing long-term contracts.

SUMMARY OF ISSUES

This Administrative Proposal focuses on five distinct issues related to new and interim contracts described in Sections 3404(a), (b), and (c):

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[1] The 12 areas of concern are the following: conservation, contracting policies, Anadromous Fish Restoration Plan (AFRP), management of Section 3406(b)(2) water, Restoration Fund, urban reliability, water transfers, refuge supply, San Joaquin River, Trinity River, Stanislaus River, and the stakeholder process.

- **Restrictions on New Contracts**—which refers to the specific statutory requirements in the CVPIA (Section 3406(b)-(d)) which must be satisfied before the Secretary can enter into any new contract other than contracts for fish and wildlife purposes.

- **Interim Renewal Contracts**—which addresses the status of contracts up for renewal pending completion of the CVPIA Programmatic Environmental Impact Statement (PEIS).

- **"Article Fourteen" Contract Amendments**—which addresses the fourteen long-term Friant Division contracts that were renewed between January 1, 1988, and passage of the CVPIA in 1992 that have not yet been modified to reflect the statutory language of the CVPIA.

- **Implementation of the "Hammer Clause"**—which addresses the surcharge imposed by Section 3404(c)(3) to encourage early renewal of contracts.

- **Mandatory Renewal**—which addresses the level of certainty of renewal of the successive long-term renewal contracts for 25 years.

Restrictions on New Contracts

CVPIA Requirements. Section 3404(a) prohibits the Secretary of the Interior (Secretary) from entering into any new short-term, temporary, or long-term contracts or agreements for water supply from the CVP for any purpose other than fish and wildlife before a series of actions takes place. One of these actions is that the provisions of sections 3406(b)-(d) be met.

Stakeholders' Views. Water users desiring new contracts have expressed concern that the requirement of Section 3404(a)(1) to meet the provisions of Section 3406(b)-(d) is vague and uncertain and will prevent the Secretary from ever offering any new contracts for CVP water. These water users believe that so long as new contracts are written and administered in accordance with the CVPIA, there should be no policy reasons against offering new contracts. Existing CVP contractors are concerned that new contracts could result in less water being available for delivery to existing CVP contractors.

Others have suggested that new contracts necessary to meet "Area of Origin" needs should not be subject to CVPIA restrictions on the issuance of new contracts. These interests have further suggested that if an exemption is not granted, then at a minimum, new contracts to Area of Origin water users should be given preferential status.

During work team sessions, stakeholders apparently agreed to a partial approach under which Interior would be asked to develop a set of criteria defining when actions required under Section 3406(b)-(d) would be considered as "met" for purposes of satisfying Section 3404(a)(1),

thereby allowing the offering of new contracts. There was no agreement in the stakeholder work team, however, on the suggested Area of Origin exemption from this requirement.

Interior's Response. Interior agrees that there is a need to define the meaning of Section 3404(a)(1). Although Interior does not presently intend to initiate any new water marketing programs, Interior recognizes that there may be limited situations in the future in which new contracts might be appropriate if compliance with Section 3404(a)(1) could be demonstrated.

Interior proposes to define what is meant by Section 3404(a)(1)'s requirement that "the provisions of subsections 3406(b)-(d) are met". Interior hopes that draft criteria defining this requirement will be available for public review prior to April 1, 1999. The stakeholder community and the interested public will have an opportunity for meaningful input before such criteria are finalized.

Interior does not agree with the proposal for an Area of Origin exemption from section 3404(a). Such an exemption does not appear, explicitly or implicitly, in the statutory language.

Interim Renewal Contracts

CVPIA Requirements. Section 3404(c)(1) prohibits the Secretary from renewing existing long-term repayment or water service contracts " . . . until appropriate environmental review, including the preparation of the [CVPIA Programmatic Environmental Impact Statement (PEIS)], has been completed." Pending the completion of the CVPIA PEIS, the Secretary is authorized to execute interim renewal contracts for an initial period of up to 3 years, followed by successive renewal periods of up to 2 years as necessary. The interim renewal contracts are to be modified to comply with existing law, including the provisions of the CVPIA.

Stakeholders' Views. CVP Contractors have raised two broad concerns. First, there are concerns about the scope of substantive contract modifications that could be proposed for the interim renewal contracts, and the possibility that subsequent interim renewals could result in reopening contract issues resolved previously. Contractors interpret Section 3404(c)(1) narrowly, arguing that contract modifications should be limited to provisions of the CVPIA explicitly made applicable to the interim renewal contracts.

Certain Delta interests believe that the scope of interim contract actions should be broadened to include a consideration of restrictions on use that would address drainage problems and Area of Origin laws. Environmental groups believe that the CVPIA provides a broad opportunity to review interim renewal contracts, including terms for the quantity of water supplied and the mechanisms used for pricing water.

The second broad concern raised by CVP contractors is the potential expense and delay of a major interim contracts renegotiation process for subsequent interim renewals. Environmental

groups and Delta interests believe the contractors' concerns are unfounded because, as a practical matter, the parties to the interim renewal contracts are unlikely to revisit or reopen major issues every 2 years.

The work team did not reach substantial agreement on these issues. Stakeholders did, however, explore the possibility of developing a short list of topics which would be reviewed during the preparation of interim renewal contracts. However, there was no agreement on what topics properly belonged on the short list; the concept went no further.

Interior's Response. Interior notes that these two concerns were addressed during the negotiation of the first interim renewal contracts. A provision was included in those 3-year interim renewal contracts to allow the contracting parties to agree in writing to simply renew the interim renewal contracts for the subsequent period of up to 2 years upon completion of environmental documentation and associated public review and comment. Alternatively, either party can find that specific provisions need to be revisited before execution of the subsequent interim renewal contracts.

Interior believes that such a renewal provision adequately addresses the issues of renewing interim renewal contracts. Interior notes that 54 interim renewal contracts expired on February 28, 1998. In preparation for those renewals, Interior determined that the "Water Shortage and Apportionment" article needed to be clarified. Contract negotiations with representatives from the 54 contractors, on May 20, 1997, led to agreement on the modification of the "Water Shortage and Apportionment" article along with corresponding changes to the "Opinions and Determinations" article. With those modifications and modest administrative changes, such as dates and actions completed, the terms and conditions of the existing interim renewal contracts will remain the same.

"Article Fourteen" Contract Amendments

CVPIA Requirements and Background. Fourteen long-term Friant Division contracts (hereinafter referred to as the Friant-14) were renewed during the period between January 1, 1988, and the passage of the CVPIA in October 1992. These contracts are the subject of continuing litigation and contain a contract provision which makes them subject to modification under certain conditions. Section 3404(c)(1) specifically requires the Secretary to amend these fourteen contracts to include a provision requiring "payment of the charge mandated in subsection 3406(c) and subsection 3407(b) of this title and all other modifications needed to comply with existing law, including the provisions of this title. This title shall be deemed 'applicable law' as that term is used in Article 14(c) of contracts renewed by the Secretary since January 1, 1988." While Interior has not yet amended these 14 contracts, it has been collecting the charges required by Sections 3406(c) and 3407(b).

Stakeholders' View. Environmental interests contend that Interior needs to expeditiously amend these 14 contracts. They contend that collecting fees does not constitute compliance with the

requirement to amend the Friant-14 contracts and that failure to amend the contracts makes it difficult to implement certain environmentally beneficial provisions of the CVPIA (such as tiered-pricing) in a timely fashion. They contend, therefore, that Interior's actions are inconsistent with the goals and objectives of the CVPIA.

CVP contractors believe that amending these contracts at this point would require needless expense without generating any significant environmental benefits. These contractors are paying the applicable fees required by CVPIA, but believe that new amendment negotiations should await the resolution of judicial and administrative issues on these contracts and on the CVPIA in general, including the completion of appropriate NEPA review. The stakeholders did not reach a consensus resolution of this issue.

Interior's Response. Interior believes that it must amend the contracts in question as outlined in Section 3404(c)(1) upon completion of appropriate NEPA review. This will ensure that results of the PEIS and appropriate divisional-level environmental review are considered prior to amendment of the Friant-14 Contracts. Interior believes, however, that its approach of collecting the applicable fees as described above is a legitimate interim measure. A timeline will be established for renegotiation which provides opportunities for public involvement in the contract amendment process.

As previously noted, the Friant-14 contracts are currently the subject of litigation, *Natural Resources Defense Council et al., v. Roger Patterson et al., No. CIV.S-88-1658 LKK.* The United States District Court entered its final order and judgment on January 15, 1997, as amended by a subsequent order issued on April 16, 1997. The final order and judgment declared, among other issues, that the Friant-14 contracts were invalid as of March 7, 1998. The affected Contractors and plaintiff environmental organizations in the litigation have appealed the final order and judgment to the United States Court of Appeals for the Ninth Circuit.

Implementation of the CVPIA "Hammer Clause"

CVPIA Requirements. Section 3404(c)(3) imposes a surcharge on existing CVP contractors who do not commit to early renewal of their contracts. The surcharge, which is an additional mitigation and restoration payment of one and one-half times the payment calculated pursuant to Section 3407(d) of the CVPIA, will be imposed beginning October 1, 1997. If the CVPIA PEIS is not completed by October 1, 1997, however, the surcharge will not be imposed on any CVP contractor who executes a binding agreement to renew immediately upon the completion of the CVPIA PEIS.

Stakeholders' Views. Contractors find it difficult to assess whether they should execute the "binding agreement" to renew their existing contracts because the environmental goals and objectives of such renewal contracts are not known at this time. CVP contractors are concerned that critical information, such as the applicable rules and regulations, may not be available for

review at the time they enter the binding agreement. The stakeholders did not arrive at a consensus approach to this issue.

Interior's Response. Interior acknowledges that delays in completing the PEIS have resulted in CVP contractors having to make a decision on executing a binding agreement without having complete information as to the results of the NEPA analysis and the contracting approach of the United States. However, Reclamation's proposed draft binding agreement allows CVP contractors to reconsider their "renew early" decision once appropriate information becomes known, subject to the statutory requirement to pay the additional mitigation and restoration fees.

On December 12, 1996, Reclamation released its draft binding agreement for public review and comment. Substantial public comments were received and evaluated. The draft binding agreement was revised in light of the comments and was mailed to CVP contractors in late August 1997 for their execution. All but one of the CVP contractors who were required to sign a binding agreement have signed an agreement.

Discretionary v. Mandatory Long-Term Contract Renewals

CVPIA Requirements. CVPIA Section 3404(c) states, in relevant part, that "the Secretary shall, upon request, renew any existing long-term repayment or water service contract for the delivery of water from the Central Valley Project for a period of 25 years and may renew such contracts for successive periods of up to 25 years each."

Stakeholders' Views. CVP contractors are concerned about the language in Section 3404(c) which provides that the Secretary "may" renew long-term repayment or water service contracts for successive 25-year periods after the initial 25-year contract. The contractors believe that the use of the word "may" creates uncertainty of renewal which is an unwarranted threat to their future water supplies and will cause them difficulty in arranging long-term financing or in making long-term plans. The contractors raise the argument that renewal should be mandatory because the CVP was formed and operates under the "trust" theory in which Reclamation holds water rights in trust for and appurtenant to the lands held by landholders served by the contractors and as a result the landholders are the "real" owners. Under this theory, Reclamation should be required to renew contracts and any "reallocation" should be the result of regulatory requirements or arrangements made between willing buyers and willing sellers.

Environmental interests generally oppose a permanent right of renewal because that right would "lock up" a substantial portion of the State's water, making it unavailable for changing societal needs. They believe that locking up this water in agricultural contracts also might encourage inefficient use of the water, with potentially adverse environmental effects. Environmental interests (as well as others, including some fishing and urban interests) also are concerned that granting a permanent right of renewal to CVP contractors could grant both a permanent

"subsidy" and a permanent "windfall" to these particular water users.[2] Environmental interests are opposed to these subsidies because they believe that charging less than full cost for water encourages wasteful use. Further, environmental interests oppose granting a permanent windfall to contractors because that windfall represents the "return" on a substantial public investment in the CVP, which they believe rightfully belongs to the public, not individual contractors.

Some environmentalists acknowledge the need to have well-defined contract rights in order to facilitate the emerging water transfer market and to maintain a stable farm economy.

Urban interests generally support guaranteed renewals.[3] Urban CVP contractors believe that guaranteed renewals for the agricultural contractors will lead to guaranteed renewals of their own CVP municipal and industrial (M&I) contracts. Additionally, urban interests that are not CVP contractors support guaranteed renewals for agricultural contractors because they are interested in purchasing water from those contractors for long-term water transfers.

These concerns have led to a general urban consensus that any solution should facilitate water transfers. This consensus has taken two forms. First, urban interests have expressed a desire to have the "ground rules" well known, so they can negotiate with potential transferors with full knowledge about what will happen at the end of the original 25-year renewal contract. Second, some urban interests have expressed a more fundamental concern that restructuring the term of renewal contacts to 25 years is not conducive to major water facilities planning efforts. That is, urban water districts trying to plan facilities for future growth usually have at least a 30- to 50-year time horizon (for financing and/or project management reasons). Relying on water transfers to increase urban supplies is difficult if the water transfer contract is based on a contract for only 25 years.

It would be reasonable to conclude that there has been little progress on resolving this issue in the stakeholder process. A draft discussion paper was initially prepared by a Reclamation participant in the stakeholder work team, and was subject to at least three revisions. That discussion paper, however, did not result in a proposed resolution. Substantial additional discussions have taken place within Interior and more informally with the stakeholder interests, and these discussions have led to the preliminary alternative proposal outlined below.

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[2] For purposes of this outline, the "subsidy" is the difference between the agricultural contract price and the full cost of service price (the difference being primarily that agricultural contractors do not pay interest on the associated outstanding capital costs). The "windfall" is the difference between the full cost of service and the fair market value of the water.

[3] Different urban interests attach different conditions to the guaranteed renewal. For example, draft proposals submitted to Congress by one urban coalition supported guaranteed renewals so long as price and quantity were negotiable.

Interior Response. Interior believes that this issue is one of the most important policy issues facing the broader California water community. The need to develop a framework for water contracting that addresses countervailing policy considerations -- that is, one that provides contractual arrangements allowing productive agricultural operations and concurrently avoids improper limitations on future flexibility to respond to the changing California water situation -- goes to the heart of how water management will be done in California over the next century. Interior believes that the scope of this issue, which goes well beyond the implementation of the CVPIA, calls for a substantial public outreach effort to assure that resolution is based on the best analysis, not only by the interested stakeholders, but also by the broader business, financial, and academic communities in California.

Public Outreach Effort - Advance Notice of Proposed Rulemaking. Interior developed the concepts in Section V, "Possible Solutions," of the draft Administrative Proposal - Part A as a public outreach effort. The public outreach effort included Interior proposing to issue an "advance notice of proposed rulemaking" describing the contracting issues and providing alternative approaches for resolution. Interior focused on two particular areas of concern: the shortage provisions and the development of a contract renewal provision to be included in the contracts. Interior's draft Administrative Proposal - Part A under Section VI "Next Steps" emphasized that the proposals described in the "Possible Solutions" section are extremely preliminary and offered for discussion purposes only. Interior further acknowledges that the concepts presented are not the product of the Contract Policies work team as the work team was unable to produce mutually agreeable potential concepts. The Administrative Proposal explains that the concepts will be scrutinized in a rulemaking process, so as to enable the broadest possible public participation and debate. The range of comments on this section was very broad and there was no consensus, except that commenters generally advocate that Interior withdraw the "Possible Solutions" section. Based on the comments received, Interior is hereby withdrawing the "Possible Solutions" section. Interior has decided these concepts should not be addressed in this Administrative Proposal. Therefore, the issue of supplemental renewal of contracts will be left to the discretion of the Secretary at the time of contract renewals for "successive periods of up to 25 years each."