



## STATE WATER PROJECT CONTRACT EXTENSION PROJECT

### Meeting Summary and Action Items

State Water Project Contract Extension Project

May 15, 2013 10:00 AM – 3:00 PM

### Negotiation Meeting Attendance List

<p><u>California Department of Water Resources</u>  <u>Lead Negotiators</u></p> <ul style="list-style-type: none"> <li>• Carl Torgersen, California Department of Water Resources</li> <li>• Perla Netto-Brown, California Department of Water Resources</li> <li>• Steve Cohen, California Department of Water Resources</li> <li>• Rob Cooke, California Department of Water Resources</li> <li>• Vera Sandronsky, California Department of Water Resources</li> <li>• Ralph Torres, Advisor, California Department of Water Resources</li> </ul> <p><u>State Water Project Contractor Lead Negotiators</u></p> <ul style="list-style-type: none"> <li>• David Aladjem, Alameda County Flood Control and Water Conservation District, Zone 7 and San Bernardino Valley Municipal Water District</li> <li>• Steve Arakawa, MWD of Southern California</li> <li>• Dan Charlton, Coachella Valley Water District</li> <li>• Kathy Cortner, Mojave Water Agency</li> <li>• Curtis Creel, Kern County Water Agency</li> <li>• Dan Flory, Antelope Valley-Eastern Kern Water Agency</li> <li>• Paul Gosselin, Butte County</li> <li>• Mark Krause, Desert Water Agency</li> <li>• Valerie Pryor, Castaic Lake Water Agency</li> </ul>	<ul style="list-style-type: none"> <li>• Deven Upadhyay, MWD of Southern California</li> <li>• Bob Perreault, Plumas County Flood Control &amp; Water Conservation District</li> <li>• Douglas Headrick, San Bernadino Valley Municipal Water District</li> <li>• Jeff Davis, San Gorgonio Pass Water Agency</li> <li>• Ray Stokes, Santa Barbara County / Central Coast Water Authority</li> <li>• Joan Maher, Santa Clara Valley Water District</li> <li>• David Okita, Solano County Water Agency</li> <li>• Mark Gilkey, Tulare Lake Water Storage District and County of Kings</li> <li>• Lisa Kern (by phone), Ventura County Flood Control District</li> <li>• Jeff Pratt (by phone), Ventura County Flood Control District</li> <li>• Matt Naftaly (by phone), Santa Barbara County Flood Control &amp; Water Conservation District</li> <li>• Darin Kasamoto (by phone), San Gabriel Valley Water District</li> </ul> <p><u>California Department of Water Resources</u>  <u>Staff</u></p> <ul style="list-style-type: none"> <li>• Ted Alvarez, California Department of Water Resources</li> <li>• Cathy Crothers, California Department of Water Resources</li> <li>• Jaime Dalida, MWD of Southern California</li> <li>• Kevin Donhoff, MWD of Southern California</li> </ul>
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<ul style="list-style-type: none"> <li>• Terri Ely, California Department of Water Resources</li> <li>• Karen Enstrom, California Department of Water Resources</li> <li>• Scott Jercich, California Department of Water Resources</li> <li>• Laura King Moon, California Department of Water Resources</li> <li>• Philip LeCocq, California Department of Water Resources</li> <li>• Chris Martin, California Department of Water Resources</li> <li>• Dave Paulson, California Department of Water Resources</li> <li>• Jackie Robinson, California Department of Water Resources</li> <li>• Nancy Quan, California Department of Water Resources</li> <li>• Elizabeth Scott, California Department of Water Resources</li> <li>• Dena Uding, California Department of Water Resources</li> <li>• Pedro Villalobos, California Department of Water Resources</li> <li>• Philip LeCocq, California Department of Water Resources</li> </ul> <p><u>State Water Project Contractors and SWC, Inc.</u></p> <ul style="list-style-type: none"> <li>• Gary Bucher, Kern County Water Agency</li> <li>• Amparo Flores, Alameda County Flood Control and Water Conservation District, Zone 7</li> <li>• Jason Gianquinto, Kern County Water Agency</li> <li>• Don Marquez, Kern County Water Agency</li> <li>• Amelia T. Minaberrigarai, Kern County Water Agency</li> </ul>	<ul style="list-style-type: none"> <li>• Josh Nelson, Best, Best &amp; Krieger LLP/Crestline Lake Water Agency</li> <li>• David Reukema, MWD of Southern California</li> <li>• John Schlotterbeck, MWD of Southern California</li> <li>• Thomas Fayram (by phone), Santa Barbara County Flood Control &amp; Water Conservation District</li> <li>• Lynn Hurley, Santa Clara Valley Water District</li> <li>• Dana Jacobson, Santa Clara Valley Water District</li> <li>• Cindy Kao, Santa Clara Valley Water District</li> <li>• Terry Erlewine, State Water Contractors, Inc.</li> <li>• Theresa Lightle, State Water Contractors, Inc.</li> <li>• Julie Ramsay, State Water Contractors, Inc.</li> <li>• Cliff Schulz, State Water Contractors, Inc.</li> </ul> <p style="text-align: center;"><u>Public</u></p> <ul style="list-style-type: none"> <li>• Bill Brennan, Central Coast Water Authority</li> <li>• Mark Bradley, Delta Stewardship Council</li> <li>• Erick Cooke, Environmental Science Associates</li> <li>• Rebecca Crebbin-Coates, PCL</li> <li>• Cathy McEfee, Environmental Science Associates</li> <li>• Debbie Espe (by phone), San Diego County Water Authority</li> <li>• Elizabeth Leeper, San Luis and Delta Mendota Water Authority</li> <li>• Dan McDaniel, Central Delta Water Agency</li> <li>• James Read, Arroyo Grande</li> </ul> <p style="text-align: center;"><u>Facilitation Team</u></p> <ul style="list-style-type: none"> <li>• Alex Braunstein, Kearns &amp; West</li> <li>• Michael Harty, Kearns &amp; West</li> <li>• Kelsey Rugani, Kearns &amp; West</li> <li>• Anna West, Kearns &amp; West</li> </ul>
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I. Welcome/Introductions

There were roundtable introductions of the negotiation teams and staff.

II. Meeting Overview

Anna West reviewed the Meeting Ground Rules emphasizing respect and listening to each other for SWP Contractors and DWR. She also reviewed how the public comment period will be conducted at the end of the meeting. Anna outlined the negotiation session agenda and stated that Objectives 3, 2a, and 2b will be discussed.

Anna then reviewed the action list from the May 1, 2013 negotiation session. Many of the action items will be addressed during the negotiation meeting today.

On Action Item #9, Carl Torgersen suggested that to show interim progress on objectives we take tallies on individual objectives asking if anyone objects to keeping the tentative agreement on an individual objective, understanding that all negotiators reserve the opportunity to consider the full package of objectives before finalizing. There were no objections to this process and therefore it will be used moving forward.

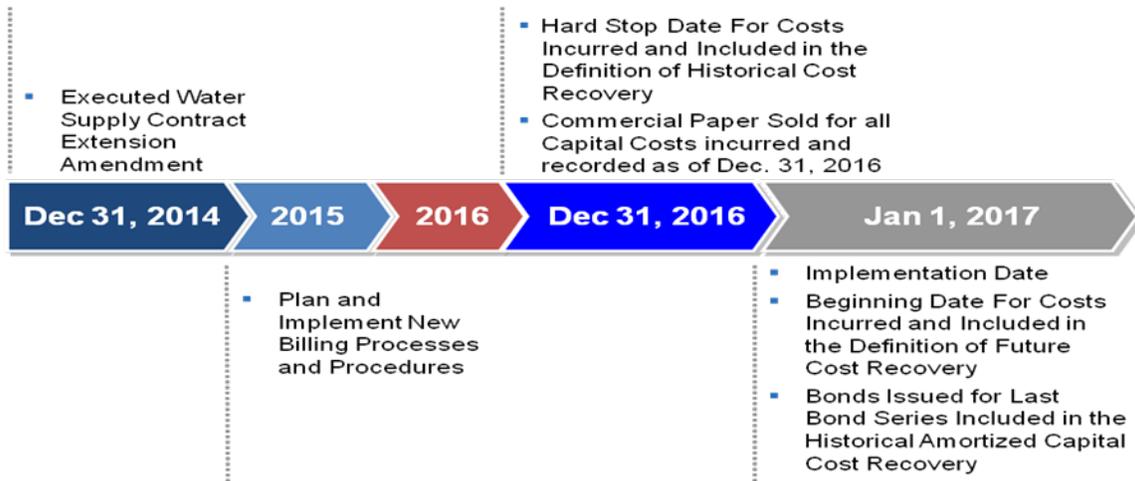
Anna reported on Action Item #8 on document management, based on discussions between Scott Jercich, Theresa Lightle, Julie Ramsay and Anna. Kearns & West will keep a log of all documents used in this negotiation process which will be posted on the website. The K&W log will have a document number, the source (DWR, SWP Contractors, individual Contractor, or K&W), and date when it was shared with the group. K&W will log documents retroactively and moving forward.

Since May 1<sup>st</sup>, Kearns & West followed up with the eight SWP Contractors who were absent, briefing them about the process and encouraging their attendance. No edits were made to the May 1<sup>st</sup> Meeting Summary beyond edits shared so it will be finalized and posted to the [Contract Extension webpage](#).

III. Objective 3: New Billing Procedure

Ray Stokes presented information on the background and proposed approach to “Freeze” the approach for all billings to date, using the current billing system through 2035, and then to have a “Pay-As-You-Go” billing procedure for all new costs that are incurred following the Contract Amendment’s implementation date. Ray explained that contract amendments are needed soon to help deal with compression issues. Bond financing in 2013 only allows for a 22-year repayment period. There is an estimated \$10 billion in capital costs over the next 20 years. SWP Contractors propose a Pay-As-You-Go approach for costs going forward to better manage these anticipated capital costs. He explained that all costs that are incurred after implementation will then use the “Pay-As-You-Go” billing system. Ray also proposed executing amendments to the Water Supply Contracts to avoid the unintended consequences caused by extending the contract term, such as needing to extend the project repayment period beyond 2035.

Ray proposed the following implementation schedule:



Following Ray’s presentation, discussion focused on Project Interest Rate and it was decided that DWR and SWP Contractors draft proposals on the Project Interest Rate, and will exchange ideas on this and other unintended consequences topics before the next Objective 3 Technical Team Meeting.

Discussion then followed about capital costs, the function of the capital facilities account, and examples of projects that are not able to be capitalized.

Perla Netto-Brown offered SAP implementation as an example of a project that was not able to be capitalized, and suggested that projects that are not financeable through bonds are infrequent. Since the “other project purposes” account will be discussed under Objective 2b and the decision may alter the billing procedure, existing cash flow, Davis-Dolwig Act costs, and other potential unintended consequences will need to be considered.

There was discussion between Steve Cohen and Ray on capital costs and other costs. Steve highlighted that there are \$2 billion in revenue bonds outstanding, and it’s important to understand that this represents an important factor in how the contract is amended. On further discussion of the SAP implementation, Perla explained that Article 1hh prevented DWR from financing this \$40 million cost through bonds. Ray suggested that perhaps 1hh needs to be amended so that costs such as this could be financed with bonds moving forward. It was highlighted by DWR that by potentially moving to “Pay-As-You-Go” moving forward, it is important to identify ways to pay for these items moving forward – thus Objective 2b.

Rob Cooke provided a list of items that would need to be amended (unintended consequences) regarding billing methodologies. These issues included amendments to the project interest rate, project repayment period, and addressing the differences between agricultural and M&I repayments. There was discussion surrounding surcharge, cash flow issues, and Freeze-Go versus Pay-Go. DWR stated that to eliminate cash flow issues, the surcharge would have to be addressed. After 2035, a surcharge would be needed given that we could be under a Pay-As-You-Go system. Ray asked if a surcharge would be needed after 2035 and Rob affirmed that a

surcharge would be needed after 2035. Further discussion on this issue will occur during the Objective 3 Technical Team meeting.

#### IV. Objective 2a: Reserves

Perla Netto-Brown provided background on why a reserve account is needed and how it was established under Article 51. She explained that the State Water Project is the largest state-built utility in the United States. It costs \$1 billion annually; however, the current reserves are only \$27 million. She explained that the Monterey Agreement established a General Operating Account under Article 51 which cannot exceed \$32 million and is a reserve for emergencies, but not for capital costs.

Perla reviewed the four reasons for reserves:

1. To address the two-year lag time between setting projections and truing up actuals received.
2. Extraordinary expenses, such as establishing an escrow account for Reid Gardner. Another example is extraordinarily large power costs during the energy crisis in 2001.
3. Normal business cycle fluctuations such as the differences between power costs under the transportation variable and the actual net power costs.
4. Emergencies.

Perla explained that the State Water Project enjoys AA and AAA ratings which create a low cost for borrowing. Having adequate cash reserves would contribute to sustaining these good ratings.

Perla explained that the Department has had over-collections in the past, but since a 4.61% interest rate is paid to the Contractors on over-collections, the DWR should not be dependent upon over-collections to serve as an artificial reserve— it's a very expensive approach. Currently, the goal is to raise the reserves account to \$200 million in today's dollars (120 days of operational reserves and power purchases). DWR proposed that the DWR should raise an appropriate level of reserves by a rollover of the general operating account balance plus annual deposits from SWP cash flow as available over a 5 to 10 year timeframe. Another option is to include a charge in the contractor's bills to collect enough money to bring the reserve to a prudent level.

Ray acknowledged that good progress is being made on understanding the needs for resources and the examples. He clarified that for emergencies we would be talking about emergencies that are not eligible for bond financing. He looks forward to additional Technical Team work to further analyze the information and understand the magnitude of cash reserves needed.

Joan Maher suggested that there are different ways to tackle each of these needs. She asked if the Department is open to exploring alternative options for each, not only establishing cash reserves. Perla affirmed that the Department is willing to entertain options as long as the Department is able to have healthy reserves that are financially prudent. DWR is currently updating some graphs included in a presentation on Reserves for the Objective 2a Reserves Technical Team. The next 2a Reserves Technical Team meeting will be scheduled once the graphs are ready.

Deven Upadhyay noted that the proposed reserves fund is much higher than it has been in the past. He asked if DWR is willing to entertain concepts on management of cash flow. It was agreed that SWP Contractors will bring concepts forward on cash management and management of the reserve.

V. Objective 2b: Other Project Purposes Account

Steve Cohen explained that there were three questions in the last negotiation meeting on Objective 2b: What is a project without a direct revenue stream? Please clarify the need for an "Other Project Purposes" fund. How would it be adjusted over time according to need?

Steve explained that modifying the contracts according to Objective 3 would create the need for an Other Project Purposes Account.

Historically, there have been situations where projects do not have a direct revenue stream or are not eligible for bond financing. This puts financial strain on cash and if contracts are extended to 2075 or 2110, it will be even more difficult to foresee these potential projects over such a long time period. Examples of these projects include future Contractor water in the San Joaquin Valley and the South Bay. The South Bay future water was recently somewhat alleviated by Alameda Zone 7 taking over the water after 40 years of DWR absorbing the costs.

Steve explained that there are also costs such as the flood allocation at Del Valle reservoir. The U.S. Army Corps of Engineers had paid some of these costs, but are not paying these going forward. There is no beneficiary or funding source and DWR is using its own capital to cover these costs. Particularly after 2035, there will be no mechanism to recover these costs. He explained that the State Water Project is a multi-purpose project – most facilities have multiple purposes and it is unclear how DWR can continue to fund other purposes other than water supply post 2035. He suggested that it is in the SWP Contractors' interests to help fund other Project Purposes to help secure the water supply. He also explained that there are suspended projects such as Jiboom Street for which the Department has no source of funding.

Curtis Creel noted that for unallocated Table A water, assuming it is available to Contractors and one of them obtains it then this would not be an issue. He asked how Oroville flood control is billed. Pedro Villalobos explained that, as of 2010, Oroville flood control costs are billed to the Contractors.

The Group agreed to have DWR generate a list of known projects or costs in the three categories (unallocated water, discretionary projects/suspended projects, and unfunded multi-purpose projects) for further discussion in an Objective 2b Technical Team. Carl clarified that Davis-Dolwig associated costs are being addressed in a different forum, and the outcome on this can be brought back to this group.

VI. Negotiation Decision Making, Objectives/Offers Review

Bob Perreault, for Plumas County, reviewed their Objective – the same as Butte's, and highlighted their reservation to add new objectives, as needed, through this process.

## VII. Next Steps

DWR and SWP Contractors discussed next steps, including setting timeframes for the Technical Team meetings for Objective 2a, 2b, and 3, where possible.

## VIII. Public Comment

There were no requests to provide public comment.

## IX. Adjourn

The meeting was adjourned.

	<b>Action Items</b>	<b>Responsibility   Due Date</b>
1	Objective 3 Simplifying Billing Procedures: DWR and SWP Contractors each draft a list of issues/unintended consequences, including the project interest rate. Exchange lists before holding the Technical Team Meeting.	Rob Cooke, Ray Stokes   ASAP
2	Objective 3 Technical Team will schedule an upcoming meeting to discuss issues. (DWR to post date one website once known).	Rob Cooke, Ray Stokes   ASAP
3	May 1 <sup>st</sup> Negotiation Session Meeting Summary to be finalized and posted on website.	Kearns & West   Done
4	DWR to update an earlier presentation for the Objective 2a Technical Team and make presentation. Once the presentation is ready, schedule a 2a Reserves Technical Team meeting.	Perla Netto-Brown, Ray Stokes   TBD
5	SWP Contractors to develop and share ideas related to Objective 2a and cash flow management.	Deven Upadhyay, Perla Netto-Brown   May 29 Meeting or June 12 Meeting
6	Objective 2b Other Project Funding: a) DWR to share suspended projects list, and also prepare a list of other projects as examples of projects that would be funded through this objective (those with no customer, multi-purpose projects). b) DWR to provide justification/reasoning for needing the other projects fund. c) Provide information on how DWR communicated with SWP Contractors (all 29) on previous projects.	Steve Cohen   May 22  Steve Cohen   TBD  Steve Cohen   TBD
7	Objective 2b Technical Team to meet during the work week of May 20 <sup>th</sup> .	Steve Cohen, Ray Stokes   May 22

Meeting Handouts:

- May 15th Negotiation Session Agenda and Ground Rules
- State Water Contractors Objective 3 Presentation
- DWR – Objective 2a: Why Do We Need a Reserve?
- DWR - Objective 3: Unintended Consequences to Billing Methodologies