



Testimony of Steve Ellis
Vice President, Taxpayers for Common Sense

Subcommittee on Water, Power and Oceans
Committee on Natural Resources legislative hearing on water settlements:
H.R. 4366 “To affirm an agreement between the United States and Westlands Water District dated September 15, 2015, and for other purposes” and H.R. 5217 “to affirm the agreement between the United States and Westlands Water District dated September 15, 2015 and the agreement between the United States, San Luis Water District, Panoche Water District and Pacheco Water District and for other purposes.”

May 24, 2016

Good morning Chairman Fleming, Ranking Member Huffman, members of the Subcommittee. Thank you for inviting me to testify. I will be focusing on H.R. 4366 and H.R. 5217, both of which would formalize agreements between the United States and Westlands Water District¹ and the Northerly Districts.² I am Steve Ellis, Vice President of Taxpayers for Common Sense, a national non-partisan budget watchdog.

In essence, the two agreements absolve the U.S. from providing drainage for irrigation water sent to the districts in exchange for numerous new benefits to the districts:

- Drainage would become the responsibility of the districts.
- In return the districts would be deemed to have paid off all capitalized construction costs for the Central Valley Project (currently estimated at over \$400 million in total). Thus the districts would be given permanent contracts for their water at a far cheaper price, along with other benefits such as transfer of various federal facilities, waiver of federal farm size limits, and a new federal commitment to permanent water deliveries from the Central Valley Project (CVP) (because of delayed environmental reviews and controversies the four districts currently only have been only able to obtain 2-year

¹ Available at <http://www.usbr.gov/mp/docs/Notice-of-Filing-Settlement-Agreement-AS-FILED-with-attachment-091615.pdf>

² Commentary based on Summary of Termsheet for a Proposed Settlement Between the United States and the Northerly San Luis Unit Districts Regarding Drainage from October 29, 2015

extension contracts for such deliveries for several cycles. Without these bills, under the CVP Improvement Act (CVPIA) these would be 25-year contracts).

- The Westlands agreement also would help resolve several different ongoing rounds of litigation and Westlands would permanently retire 100,000 acres of its 600,000-acre district (we understand most of these lands have already been retired under various prior programs or agreements).
- The Northerly Districts (San Luis, Panoche, and Pacheco Water Districts) would also receive a new federal payment of \$70 million.

There are other factors in the agreements, but these are the main ones I will be discussing. Also, the full Northerly District agreement has not been finalized, so my commentary will be mostly Westlands-focused, but would still generally apply to what I have seen about the other proposed agreement.

At this time, Taxpayers for Common Sense is opposed to the legislation. It is not that we don't want to see a resolution to this fight. We absolutely do. We just don't think this is the best or even a good deal for taxpayers.

Drainage

It is true that this deal would end the court-mandated requirement that the U.S. provide drainage for these districts. The districts would take on the responsibility for ensuring adequate drainage. But considering that the cost of providing drainage for these districts is estimated in the billions of dollars, it is also not clear how the districts would be able to do this.

There have been suggestions that drainage supplied by the districts would entail small-scale treatment, growing salt-tolerant crops, more efficient irrigation, and I would imagine further land retirement. Westlands has estimated that this will cost "hundreds of millions of dollars."³ Not billions. But there is no guarantee that this will actually happen.

This disparity in cost estimates is even harder to credit considering that Westlands recently paid a penalty to settle a Securities Exchange Commission (SEC) enforcement action over misleading investors regarding a \$77 million bond offering in 2012. The SEC found an order-of-magnitude disparity in the promised debt service coverage ratio and the actual coverage ratio. Why? Because Westlands used self-described "Enron accounting" in an effort to not raise water rates for Westlands customers.⁴ Similar accounting practices might explain how Westlands anticipates costs an order of magnitude lower than the Reclamation estimated costs, but they don't provide sufficient assurances to the taxpayers that Westlands can meet its drainage obligation.

³ Bettina Boxall Los Angeles Times "Westlands Water District Agreement a Retreat From Previous U.S. Plan" September 22, 2015 Available at: <http://www.latimes.com/science/la-me-westlands-20150922-story.html> Quote from Tom Birmingham, General Manager Westlands Water District.

⁴ SEC Press Release "California Water District to Pay Penalty for Misleading Investors" March 9, 2016. Available at <https://www.sec.gov/news/pressrelease/2016-43.html>

The agreements and certainly the legislation contain no practical enforcement measures to ensure that the districts will provide adequate drainage, or even provisions for monitoring and testing. The only apparent “enforcement” tool is that if the U.S. somehow learns that any of the districts has somehow violated applicable law, the U.S. could (but is not required to) impose the ultimate sanction of stopping all water deliveries to the district – a rarely used federal power around the West.

Thus, under this agreement, Westlands landowners could continue to grow crops on their land until they can’t anymore and then start reselling the promised water (either within the district or to cities or farms outside the district). Or they could use the affected lands for solar energy development and sell the water. Or they could retire more acres and grow more profitable crops on a smaller subset of lands. TCS wouldn’t oppose any of these options, but it would mean that the value of the drainage obligation government is shedding is a pittance compared to what Westlands is getting, and TCS would prefer that the government make a better deal in exchange.

Land retirement

The Northerly Districts’ agreement requires no land retirement at all, and the Westlands agreement includes a provision for Westlands to retire 100,000 acres from the 600,000-acre district. It has been widely reported that much of this land has already been retired. Furthermore it is a paltry amount considering what had been discussed in the past. In 2002, the top Westlands official wrote in the Bakersfield Californian that they were considering removing 200,000 acres from production – proudly stating it was one third of the district – as part of an earlier proposed drainage settlement.⁵ The government’s 2007 Record of Decision on the drainage issue recommended that nearly 200,000 (194,000) acres be retired.⁶ And in a 2010 letter to Sen. Feinstein (D-CA), then-Commissioner of Reclamation Michael Connor (current Deputy Secretary of Interior) wrote that Westlands should be “required to permanently retire a minimum of 200,000 acres of the most drainage impaired lands” as part of a settlement.⁷

Considering the consensus on 200,000 acres from so many parties – including both Westlands and Reclamation – only including 100,000 acres in the agreement is surprising at best. It’s very likely that between lands too salt-impacted/drainage-impaired for cultivation and an effort to reduce drainage costs, Westlands will retire at least 200,000 acres if not more. In my opinion this deal is really about water.

⁵ Bakersfield Californian “Another View/ Tom Birmingham: Westlands Seeks to Help All Farmers” May 1, 2002

⁶ San Luis Drain Feature Re-evaluation Record of Decision March 2007 available at http://www.usbr.gov/mp/mp150/envdocs/San_Luis_Drainage_Feature_Re-evaluation_ROD.pdf

⁷ Letter from Michael L. Connor, Commissioner, U.S. Department of Interior to Senator Dianne Feinstein. September 1, 2010

Water

How is land retirement tied to water? In the 2010 letter to Sen. Feinstein, then-Commissioner Connor stipulates that the current contract amount of water for Westlands (1.193 million acre-feet) should be reduced by a proportion equivalent to the amount of district land retired. This was estimated to result in a new contract total of 806,000 acre-feet (still an enormous amount of water and a generous 70 percent of the old contract amount). It only makes sense. Less land to irrigate, less water needed. The agreement abandons this common sense proposition and doesn't reduce the contract amount. Instead it stipulates in effect that Westlands should get 75 percent of the contracted amount or 895,000 acre-feet. In wet years, water in excess of that would be available to Reclamation for their use or to resell to others, including Westlands, in Reclamation's sole discretion.

First, the higher total contract amount means tiered water pricing (water price increases for amounts delivered in excess 80 percent of total contract amount) would never come into effect. Instead of having to pay higher-tiered prices at 80 percent of the water potentially delivered to its smaller land area, Westlands would at maximum receive 75 percent of the higher contract amount. The 75 percent level would in effect become 100 percent of what Westlands is entitled to under the law if H.R. 4366 or H.R. 5217 is enacted, and the higher-tiered pricing would never go into effect.

Also, if a higher land retirement figure were used – like say, 200,000 acres, twice what is in the agreement – it would be hard to justify (under both state and federal legal principles) contracting for that much water to be delivered and not change the total contract amount. And by promising that future annual allocations will be based on the full 100 percent contract total, rather than a reduced amount (whether 70 or 75 percent), it ensures that Westlands will always get a larger share relative to other CVP junior contractors who have allocation percentages based on their actual contract amounts.

In addition, under the agreement Westlands would be considered to be “paid out” and their water contract would convert from a 9(e) water service contract to 9(d) repayment contract. This would be a permanent contract as opposed to the normal contract renewals that should occur every 25 years under the CVPIA. In his letter to Sen. Feinstein, then-Commissioner Connor supported the idea of a longer-term contract than 25 years, but not a permanent contract. Promising a permanent contract with total amounts that are set in binding agreements and/or federal statute regardless of potential future impacts population growth, other business users, climate change, or other factors disregards the long history of water strife and challenges faced in the arid west. At a minimum, such a proposal should have been analyzed for its impact on other federal and taxpayer obligations before the Administration signed a Settlement Agreement committing the U.S. to such a new policy for Westlands.

If, as we suspect will happen, Westlands goes ahead and retires more land, that excess water would be money in the bank. The excess water they received at artificially low rates would then, obviously, become much more valuable in the market.

True Value

Speaking of money, in an April 21, 2016 letter to Congressman David Valadao (R-CA, and author of H.R. 4366) regarding the Westlands agreement, Deputy Secretary of Interior Michael Connor attaches a table entitled “U.S. Bureau of Reclamation’s Assessment of Costs and Benefits to Federal Government of Westlands’ Drainage Settlement (Presented in Present (2015) Net Worth).”⁸ This net present value analysis discounts future costs and savings to account for the time value of money and bring everything into 2015 values. This analysis estimates the agreement would save the government a little less than \$1 billion - \$968.9 million. This is absolutely the economically appropriate way to analyze the deal. Money coming in two decades or more from now is less valuable than money today. But economic analysis is only as good as the assumptions that accompany it. That is where this analysis fails.

Deputy Secretary Connor stipulates that the analysis used “current applicable law.” Such an analysis fails to consider that these bills are in the process of making law, and could instead alter expectations to improve financial arrangements for the taxpayer. The “current applicable law” goes back to the Reclamation Act of 1902. That means the beneficiaries of the drain would not have to start repaying for the project until it is complete. And under “current applicable law” the beneficiaries would have 40 years to repay at no interest. Zero, zilch, nada.

Reclamation’s analysis anticipates the Congress would appropriate and the U.S. would spend \$2.5 billion on drainage to complete the project by 2030. In 2070, when the last of the \$2.5 billion loan is repaid, the net present value of that total repayment in 2015 would be only \$1.2 billion. These long-term, no-interest loans arguably made sense at the beginning of the last century as small farmers got started and Reclamation was encouraging settlement of the West. Providing a 40-year no-interest loan in 2016 to Westlands – a wealthy, powerful water district that brags that its growers produce more than \$1 billion worth of food and fiber every year – makes no sense.⁹ I reject the savings analysis because of its fundamental assumptions.

Authority

Even if it is true that the law of the land still allows for such repayment terms, it is also true that under the law providing for the construction of the San Luis Unit there was only \$513 million in remaining available authority as of 2015.¹⁰ So to even construct the drain and an equivalent new drainage system, additional legislation providing billions of dollars in budget authority and

⁸ Letter from Michael L. Connor, Commissioner, U.S. Department of Interior to Representative David Valadao April 21, 2016.

⁹ <http://wwd.ca.gov/about-westlands/>

¹⁰ Bureau of Reclamation U.S. v. Westlands Settlement Agreement Fact Sheet Oct 2015 available at <http://wwd.ca.gov/wp-content/uploads/2015/10/westlands-vs-united-states-settlement.pdf>

appropriations would be necessary before construction could be initiated. New law, new terms. Taxpayers for Common Sense has long been on the record that there should be significant reforms to water project financing and to price water to reflect market realities. A reauthorization of the San Luis Unit would provide an ideal opportunity to change these decades-old policies. The facts of the Westlands situation are a perfect recipe for such fiscal and pricing reforms to reflect the new realities that have developed since the 1902 Act and the 1960 San Luis Act.

Conclusion

I want to reiterate that TCS wants this issue to be resolved. But we don't think that these agreements and this legislation resolve the issue in a way that is fair to taxpayers.

Thank you for the opportunity to testify and I will be happy to take any questions you might have.