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**DISCUSSION PAPER ON THE WATER TRANSFER ELEMENT
CALFED WATER USE EFFICIENCY COMPONENT**

June 4, 1997

Introduction

The CALFED Bay Delta Program is developing a long-term solution to problems affecting the Bay-Delta system, including problems associated with ecosystem quality, water quality, and water supply reliability. CALFED recognizes that water transfers are an important part of the water management landscape and can be valuable in the effort to improve water supply reliability, water use efficiency, water quality and the aquatic ecosystem. Transfers can provide an effective means of moving water between users on a voluntary and compensated basis, as well as a means of providing incentives for water users to implement water management practices which will improve water use efficiency. Transfers can also provide water for environmental purposes in addition to the minimum instream flow requirements.

The CALFED Water Transfer Element will emphasize and encourage the development of a policy framework for a rational and regulated market for transfers, both short and long term. The goals of this policy framework are those that have been established for the Program:

- to reduce the mismatch between Bay-Delta water supplies and current and projected beneficial uses dependent on the Bay-Delta system;
- to improve and increase aquatic and terrestrial habitats and improve ecological functions in the Bay-Delta to support sustainable populations of diverse and valuable plant and animal species; and
- to provide good water quality for all beneficial uses.

A prominent feature of each draft CALFED alternative is modification of Delta water conveyance, ranging from modest changes in operations to major physical changes in Delta configuration. These changes in the Delta would, to varying extents, address the need for adequate flexibility and capacity in Delta conveyance facilities so that transfers can be accomplished without impairment of the delivery of Central Valley Project and State Water Project water supplies. In addition to these physical or operational changes in the Delta, the Water Transfer Element may propose that the agencies which have regulatory authority over transfers, or which control the facilities to which others must have access for transfers, coordinate their rules and criteria for approval of transfers, in order to achieve more uniformity and consistency. The Water Transfer Element will also address other policy or institutional

changes which will facilitate transfers and will provide assurances of reasonable protection from adverse environmental and third party impacts.

CALFED recognizes that water transfers can have adverse as well as beneficial impacts. CALFED actions to reduce conveyance constraints or facilitate cross-Delta transfers could potentially exacerbate adverse impacts associated with water transfers. In order to minimize or mitigate the adverse impacts of water transfers, the CALFED Water Transfer Element will be guided by the five criteria articulated by the Governor in his 1992 water policy statement.

Excerpt from Governor Wilson's April 1992 Water Policy Statement

"Just as we've learned to harness the power of a vast reservoir, so should we also learn to harness the power of market forces. The success of our State Water Bank proves that voluntary transfers -- or water marketing, as some term it -- does work, and I want to see it work on an even larger scale.

But water is a vital resource . . . vital to the life of a poor, small town, an estuary, and to a big city of vast wealth. But it may be even more critically necessary to the rural area with its economy almost entirely dependent upon agriculture and the availability of irrigation.

For that reason, even if it's possible to create a totally free water market, there are still key issues that must be resolved with great care to develop a fair and effective transfer policy.

Care must be given to the impact of transfers upon groundwater resources, fish and wildlife, protection of rural communities, and the determination of which entities should have a role in the approval of transfers, and just what that role should be.

There are many pending state and federal legislative initiatives regarding water transfers. Unfortunately, some of them are guaranteed to release only a whitewater flood of lawsuits. I will support legislation that, at a minimum, meets these criteria:

First: Water transfers must be voluntary. And they must result in transfers that are real, not just paper. Above all, water rights of sellers must not be impaired.

Second: Water transfers must not harm fish and wildlife resources and their habitats.

Third: We need to assure that transfers will not cause overdraft or degradation of groundwater basins.

Fourth: Entities receiving transferred water should be required to show that they are making efficient use of existing water supplies, including carrying out urban Best Management Plans or Agricultural Water Efficiency Practices.

Fifth and finally: Water districts and agencies that hold water rights or contracts to transferred water must have a strong role in determining what is done. The impact on the fiscal integrity of the districts and on the economy of small agricultural communities in the San Joaquin Valley can't be ignored . . . any more than can the needs of high value-added, high tech industries in the Silicon Valley.

Of course, our water belongs to all the people of California. State control is more likely where transfers involve use of the state plumbing system, and where our environmental obligations could be affected.

Most of all, in times of severe hardship, the state must be able to provide water to meet critical needs. But within these limits, there are strong roles for both a state-operated Water Bank to ease hardship or satisfy emergency needs and for a free market."

In addition to the Governor's policy, both California law and federal law (the Central Valley Project Improvement Act) include provisions that authorize and acknowledge transfers as reasonable and beneficial uses of water. However, even with this policy framework and a significant body of statutory law on transfers, there are a number of issues and questions which continue to arise and CALFED has been encouraged to address these issues and questions in the long term Bay Delta Program.

BDAC Policy Review

The question of how the CALFED Program should approach water transfer issues was presented to BDAC for policy advice. BDAC concurred that water transfers are an appropriate and useful part of the CALFED water management strategy. BDAC members also expressed the view that the CALFED program should consider several water transfer issues, including third party impacts, protection of water rights, and the proper roles of water rights holders and water users in the review and approval process for transfers.

Structure and Content of the Water Transfer Element

There are four parts to the CALFED transfer element.

First, where the administrative policies or actions of individual CALFED agencies affect water transfers, examination of these agency policies or actions may be appropriate, and CALFED will recommend and encourage that CALFED agencies adopt and implement uniform, integrated rules and criteria for the processing and approval of water transfers and for access to storage and conveyance facilities. These rules and criteria will be structured to assure that the

result of water transfers includes not only an improvement in water supply reliability, but also a net improvement in ecosystem quality and water quality.

Second, the CALFED Program will address the need for adequate flexibility and capacity in Delta channels and conveyance facilities, so that transfer water can be moved across the Delta efficiently and effectively, without interfering or conflicting with the delivery of Project water supplies.

Third, CALFED may develop and submit to forums outside the CALFED process recommendations on water transfer policy or legislative needs. Such recommendations could relate to the further development of a rational and regulated water transfer market in California which is consistent with the Governor's five criteria, or measures to support these criteria such as protections for water rights, instream flows, groundwater levels, or third parties.

However, the initial premise of the water transfer element will be to rely on the existing legal structure as much as possible. CALFED will assume initially that new state or federal legislation is not necessary in order to "improve" the existing water market/transfer structure. Most of the barriers which exist are administrative, technical, political and socio-economic, not legal. If issues are identified which can only be resolved by legislation, those will be included in the CALFED legislative package or sent to a forum outside the CALFED process for negotiation.

Fourth, the transfer element will be structured to avoid impacts on local environments, groundwater, and third parties whenever possible. The transfer element will include assurances that any unavoidable impacts will be adequately mitigated.

Objectives of the Water Transfer Element

In addition to the CALFED goals listed above, there are objectives specific to the Water Transfer Element.

- a. Promote, encourage and facilitate the development of a water transfer market in California, within the framework of the Governor's water policy.
- b. Address the institutional, regulatory, and assurance issues which need to be resolved to provide for an effective water transfer market.
- c. Address the physical issues which need to be resolved to provide for effective cross Delta water transfers.
- d. Encourage a transfers market that results in a net improvement in water supply reliability.
- e. Encourage a transfers market that results in a net improvement in ecosystem health.

- f. Encourage a transfers market that results in a net improvement in water quality.
- g. Encourage a transfers market that accommodates the avoidance of adverse impacts where possible, and adequately mitigates adverse impacts where avoidance is not feasible.
- h. Promote and encourage uniform rules for transfers using state and federal project facilities and cross Delta conveyance capacity.
- i. Promote and encourage the development of standardized rules for transfers that involve replacement with groundwater and other conjunctive use type transfers, so that there is no degradation of groundwater basins and long-term groundwater levels are sustained or improved.
- j. Identify and promote understanding of Delta carriage water issues as these relate to interbasin water transfers.

Essential Elements of an Effective Water Market

The existing water transfer market and the history of specific transfer programs, such as the State Water Bank, indicate that there are essential elements or fundamental requirements of a water transfer market which would operate within the framework of the Governor's water policy and achieve the CALFED objectives.

- a. The seller must have a quantifiable and transferable interest in a water supply. This interest must be clearly defined, legally and technically. All interested parties should be able to agree on the nature and quantity and transferability of this interest in water.
- b. The transfer must occur between a willing seller and a willing buyer at a price and on terms mutually agreeable to both.
- c. There must be sufficient, available and reasonably priced capacity (pumping, conveyance and storage) in the plumbing systems (Delta, aqueducts, and local systems) to accommodate the transfer, without dislocating higher priority movements of water (i.e., Project contract deliveries).
- d. The parties should be able to avoid adverse environmental impacts or mitigate to an acceptable level, including adverse impacts on local groundwater resources.
- e. The parties should be able to avoid local socio-economic impacts or mitigate to an acceptable level.
- f. The parties should be able to accomplish the transfer in a timely manner through a regulatory process (permits and approvals) that is clearly defined and understood. The regulatory process should be constructed and operated to facilitate, not discourage, transfers.

g. A mechanism must exist to get buyers and sellers together.

Issues to Resolve in Developing an Effective Water Market

A number of issues related to water transfers and the water market have been identified through the CALFED public process. Some of these issues are legal; some are political or policy based; some are administrative or technical. Some issues exist because of misunderstanding or lack of understanding about how the current water transfer market operates.

Additionally, other component and elements of the CALFED Bay Delta program assume and rely on the existence of a rational, well regulated statewide water market. The CALFED water transfer element can be used to identify and resolve issues which have impaired the development of a more efficient water transfer market or which will allow the other CALFED Program components to function more effectively. Some of these issues are:

- a. uncertainty about the definition of saved or conserved water;
- b. uncertainty about the definition of transferable water;
- c. lack of agreement on carriage water requirements in the Delta;
- d. the argument over user vs District initiated transfers;
- e. timing and processing problems (e.g. State Board permits and approvals, DWR/USBR approvals, CEQA/NEPA/ESA compliance);
- f. local ordinances restricting groundwater exports;
- g. lack of agreement on the nature, extent and ability to mitigate third party impacts.
- h. reservoir refill criteria and policies.
- i. priority of access to project facilities for transfer water.
- j. role and treatment of water transfers that result primarily in water quality improvements rather than improvements in water supply reliability.

Tools

In the context of the objectives and issues described above, a number of tools are available to CALFED which may be of some utility in facilitating the development of a statewide water market.

1. Comprehensive Water Transfer Rules - A uniform and comprehensive set of rules and definitions for water transfers could be proposed based on the existing statutory framework.

Critical items of comprehensive water transfer rules would include:

- (a) a consistent and uniform definition of what constitutes saved or conserved water;
- (b) a consistent and uniform definition of what constitutes transferable water;

[Note: Transferable water can generally be defined by either of two ways: 1) water associated with reductions in consumptive use, irrecoverable losses, or actively managed and monitored conjunctive use; or, 2) water associated with reductions in applications, diversions and recoverable losses.]

2. Water Rights Assurances - Existing water rights law provides protection of the underlying contract or water right on which the transfer is based. Existing law also provides that water that is not used for five years is abandoned or forfeited. The law is also clear that conservation of water and transfers of water are reasonable and beneficial uses. Some agricultural water users are nonetheless concerned that water saved or transferred for other uses might be forfeited after a period of years, or that as a political matter, it will be difficult if not impossible to recover water from an urban area which has come to rely on the transferred water. This is a powerful disincentive to conserve or to achieve a higher level of efficiency and it acts as a disincentive to engage in long-term transfers. New legislation or specific contractual provisions may be able to address this issue, by providing the transferor with adequate assurances that water needed in the future would be recoverable. Such assurances would effectively reaffirm existing law, the water rights priority system and the county of origin and watershed protection priorities.

3. Agreements or conditions to agreements that will provide for avoidance or mitigation of third party impacts on groundwater conditions, the local economy, and the local environment -

4. Administrative rules or policies to provide for streamlining of the current permitting and approval process -

5. Conditions for transfers - Water agencies wishing to buy water through transfers would be subject to conditions prior to approval of the transfer. Conditions could include requiring the receiving agency to be a signatory to the agricultural or urban MOU, have an adopted and implemented a water management plan, or other conservation based conditions. A priority system for approval of transfers may be given to agencies who have met these conditions.

6. Water Transfer Tax or Fee - A tax could be levied on all transfers to provide the source water county with a revenue stream to mitigate local socio-economic impacts. Money derived through this tax would be used to offset increases in social programs or other aspects that may be affected because of the transfer. Such a tax could also be structured to control the amount of water transferred out of any one region by creating a progressive tax (e.g., the tax rate would increase for each additional block of water transferred from the region). This would increase the cost of the water and require buyers and sellers to analyze the opportunities and impacts more closely.

7. Environmental Water Tax - A tax or surcharge consisting of a percentage of the transfer water itself could be imposed on cross Delta transfers. This water would become part of the resource pool of the ecosystem restoration program. An environmental water tax might vary according to the impact of the proposed transfer: transfers that increase flows during critical periods might incur little or no water tax, while a transfer with serious environmental impacts might be taxed more heavily.

8. State Drought Water Bank Conditions - Conditions currently are placed on agencies wanting to participate in the state's Drought Water Bank (Bank). The Bank rules provide that no water will be made available to any buyer who has not implemented water management practices according to the terms of the agricultural or urban MOU. Similar conditions could be placed on those wanting to sell water to the bank. Agencies that do not meet the requirements could be precluded from receiving Bank water or could be required to pay an additional premium for the water delivered (i.e., a surcharge).

Possible CALFED Approaches to Address These Issues

The CALFED water transfer element may include recommendations or proposals to CALFED agencies and to other forums or processes outside CALFED on how a more efficient water transfer market can be developed, consistent with the CALFED solution principles and the Governor's water transfer policy. Some of the possible approaches are:

- a. Recommendations for DWR, USBR and State Board on permit streamlining (timing and processing problems).
- b. Agreement among agencies and stakeholders on definitions of conserved water and transferable water (real vs paper water).
- c. Agreement among agencies and stakeholders on carriage water considerations for cross Delta transfers.
- d. Agreement among agencies and stakeholders on reservoir refill criteria.

e. Interagency and stakeholder agreement on how access to project facilities can be provided for long-term transfers.

f. Proposals for addressing groundwater issues, e.g. - should groundwater substitution transfers be approved if there is no "approved" conjunctive use program?

g. Proposals for addressing third party impacts, e.g. - should transfer price include payment to county or other local entity if this would mitigate identified socio-economic impacts?

Process

At the May 22 BDAC Meeting, Chairman Madigan announced that he will be appointing a BDAC Work Group to consider the policy issues related to transfers and the appropriate role of CALFED in developing a water policy/water market framework. Several of the issues identified in this paper will undoubtedly become the subject of discussion by the Work Group. The Work Group may identify other issues which will need to be considered.

Many of the issues identified here can probably be resolved at the agency or staff level, particularly those which are more technical in nature. Perhaps one of the first tasks for the agency committee is to determine which issues it should work on and which should be referred to the BDAC Work Group. Some of the issues will no doubt be discussed in both forums, and the agency committee can perhaps provide background and technical information to the Work Group on those issues.

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