

## **Beneficiaries Pay: Implications for Cost Allocation**

### ***Introduction and Disclaimer***

This paper is intended to facilitate discussion of Financial Strategy issues, not to present a final plan or proposal. Topics in this paper have not been fully reviewed, discussed or approved by CALFED agencies or stakeholder interests. Suggestions or concepts found in this paper are intended to illustrate only trial approaches, and are fully subject to modification or elimination prior to the development of any proposal for final CALFED agency approval.

This paper addresses a limited number of critical issues, but does not represent a full strategy for funding a Preferred Alternative. In particular, this paper is focused on working through several of the issues relating to water users and the Common Programs, including the Ecosystem Restoration Program (ERP). Other important aspects of the Financial Strategy are not discussed in detail.

### ***Benefits-Based Cost Allocation***

Sharing the costs of the Preferred Alternative based on the benefits to be received is the cornerstone principle of the CALFED Financial Strategy. The fundamental philosophy is that costs will be paid by the beneficiaries of the actions, as opposed to seeking payment from those who, over time, may have been responsible for causing the problems being experienced in the Bay Delta system. This does not preclude obligations for mitigating harmful impacts, if a direct, ongoing, cause and effect relationship can be established.

### ***Settling the Baseline Issue***

The first issue that must be resolved is the so-called baseline issue. The essence of this issue is that water users owe some amount of redress to the ecosystem program for damages inflicted in the past.

This concept of damage payments based on past acts is not useful for two main reasons:

- First, it is not possible to accurately apportion the blame for the degradation of the Delta on any particular user or group. The Delta ecosystem has been affected by human activities for over 100 years, probably beginning with hydraulic mining processes and reclamation in the 1800's, as well as natural processes. While it is true that diverting water from and above the Delta has had an impact, many other human activities have also affected the Delta, and it is impossible to prove the level of damage attributable to each. As a result, pegging the dollar amount of any such redress would be arbitrary.
- Second, it is detrimental to the process of trying to solve the problem. To try to place blame for past acts and to assess arbitrary amounts on water users in order to fund ecosystem restoration will lead to fighting and bickering, not to fixing the Delta or the

## ***DISCUSSION DRAFT***

ecosystem. CALFED agencies have determined that solving the problem is their priority; not finding out who caused it.

As a CALFED principle, the benefits-based approach means that any obligations for mitigation should be limited to ongoing direct impacts, as opposed to historical impacts. Eliminating the concept of redress for past acts does not relieve water users or anyone else from obligations relating to ongoing impacts.

### ***Addressing the Need for Good Water Management***

The next issue to resolve is how to address the financial and water management issues raised by in conjunction with the baseline issue. The following needs have been articulated:

- Funding for the ecosystem restoration program must be adequate to enable its successful implementation. The funding concern relates to the unpredictable and limited nature of public funding sources. If the ERP were to be paid for using only public funds, that could subject it to a continuing struggle for appropriations that could result in the funding being too limited and unreliable. Some portion of user funding would result in greater and more reliable funding for the ERP over time. The underlying need is to assure that the ERP has sufficient, reliable funding over time.
- In order to make appropriate resource use decisions in the future leading to a sustainable Delta system, all resource users including waters users must consider the full costs of their actions including their effect on the ecosystem. The sustainability concern relates to the fact that if resource costs do not accurately reflect the full costs of use, including ecosystem impacts, this could result in decisions over time that could undermine the objectives and success of the Program, even if the initial Program appeared to be effective. Incorporating an appropriate amount of the costs of the ERP and other Common Programs in the cost of using Delta resources would result in a more accurate reflection of the full costs of resource use in the decision-making process, resulting in decisions that would maintain or enhance the effectiveness of the Program over time. The underlying need is to incorporate the full costs of resource use, including ecosystem impacts, in the price of water and other Delta resources, particularly for new facilities considered as part of a Preferred Alternative.

### ***User Funding for the Common Programs***

One key to addressing the need for funding without attempting to unravel the past can be found in differentiating between redress for past acts and mitigating ongoing impacts. For example, portions of the Common Programs could be considered as required to mitigate the ongoing impacts of water diversion and impoundment in the Bay-Delta system, and paid for with water user funds.

One example of this concept could relate to the ERP flows. The rationale for water user funding for ERP flows is based on the premise that natural flows would be ideal for ecosystem purposes. The only reason that the ERP flows are needed is that ongoing diversion and impoundment alter natural flows to the extent that additional flows

## ***DISCUSSION DRAFT***

are required at certain times to preserve ecosystem health. Some portion of the cost of mitigating these ongoing impacts, whether through new storage or from other sources, could be borne by all users of water in the Bay-Delta system, including agricultural, urban, ecosystem, and power users.

Other portions of the Common Programs could also be funded through a water user charge that was paid by all of those whose use affects the Bay-Delta system.

Instituting a charge on all Bay-Delta water use would work to satisfy both of the needs outlined above: the cost of water usage would reflect ecosystem impacts and the Common Programs would have additional, stable funding from water users. Such a charge would be an effective tool as part of the overall Financial Strategy for funding a Preferred Alternative.

The justification for the charge would need to be based on a review of each of the Common Programs and a finding of either water user benefits, or direct ongoing mitigation obligations, or both. These funds could be earmarked for specific purposes, such as ERP flows, or viewed as an overall funding source for all Common Programs.

Water users are not the only users that affect the system. For example, fisheries also enjoy the benefits of the Delta. Over time, the effects of the Common Programs are expected to increase fish populations, which would be a benefit to fishing interests. To capture the incremental benefit to fisheries, end-user revenues from sport and commercial fishing permits and licenses in excess of the historical amounts could be pledged to the Common Programs, further supplementing public funding for implementation of the programs. It should be noted that there might be other potential end-users that could be subject to new charges that would appropriately be designated for the Common Programs, such as property owners in the Delta who receive flood control benefits.

After determining all appropriate user funding obligations, State and Federal funding could provide the remainder of the direct costs of the Common Programs. It would be incumbent on the assurances package to put in place sufficient measures to ensure that the funding sources identified for the Common Programs are reliable on an ongoing basis.

In addition to direct financial obligations, it should be acknowledged that other agencies and users might face additional costs related to the Preferred Alternative to the extent that regulatory actions impose new requirements on such entities. For example, a requirement that diversions must be screened would impose additional costs on diverters.

### ***Storage and Conveyance Facilities***

A second key to addressing the water management needs identified in conjunction with the baseline issue lies in ensuring that the full costs of new water development infrastructure, again including ecosystem impacts, are borne by those receiving water from the new facilities.

For purposes of Storage and Conveyance facilities, the benefits-based principle means that the users of these facilities should pay the full cost of the facilities.

## **DISCUSSION DRAFT**

### Storage

New storage facilities have been assumed for analysis to include 1/3 of their capacity for ecosystem purposes. Water for ecosystem purposes from any new storage facilities would presumably be used to provide ERP flows. As outlined above, providing for ERP flows could be construed as mitigation for ongoing diversion and impoundment throughout the Delta system, and could be funded in part through a water user charge on usage throughout the watershed and Delta service area. The cost of mitigating these system-wide impacts should not be borne solely by those users participating in the new storage facilities, but they should pay their share of any system-wide charge based on their usage.

It may be determined that building new storage is not the most cost-effective way to secure the water for ERP flows. If this were the case, then water users could pay the costs of securing the water for ERP flows from the other source(s).

Water users contracting to participate in the portion of the new storage from which they will receive the water (2/3 of the capacity in the analytical models) should pay the full share of that portion of the new storage.

### Conveyance

New conveyance facilities provide benefits to those that would receive water delivered through the facilities. This means that those contracting to receive water through any facilities should pay the full costs of the facilities. Some portion of the conveyance could conceivably be used for ecosystem-related flows (for refuges, for example) in which case that usage would receive a cost allocation in the same manner as other uses.

### Storage and Conveyance Planning Costs

As has been the case so far with the entire CALFED Bay Delta Program, public funding has been used for part of the planning process for Storage and Conveyance facilities. This is expected to continue into Phase III of the Program. The Storage and Conveyance planning must go forward along with other components of a Preferred Alternative.

In order to adhere to the principle that users must pay the full costs of new facilities, any portion of these planning costs not paid for by users directly must eventually be reimbursed by those water users contracting to participate in the new facilities. Using public funding is a practical decision, based on the premise that fixing overall Delta resource problems is in the public as well as user interest, and expenditure of public funds is appropriate for some portion of the planning process to do so in order to obtain objective planning analysis.

In addition, part of the early planning costs could be paid from revenues of the delta user charge, in order to ensure that users do not rely on public funding for planning only to later decide not to participate, leaving the public paying for all planning costs.

## ***DISCUSSION DRAFT***

### **Summary**

This paper suggests a number of critical concepts relating to the Financial Principles for funding the CALFED Preferred Alternative. These concepts are summarized as follows:

- The concept of damage payments based on past acts should be abandoned as not useful because it is not possible to accurately apportion the blame for the degradation of the Delta on any particular user or group, and it is detrimental to the process of trying to solve the problem.
- Instituting a charge on all water users in the Bay-Delta system, the proceeds of which would be used to fund the Common Programs, should be a part of the Financial Strategy. Other related end-user funds, such as incremental fishing license revenues, should be used as well.
- For purposes of Storage and Conveyance facilities, the benefits-based principle means that the users of these facilities must pay the full cost of the facilities. The share of new storage facilities dedicated to ecosystem purposes, if applicable, should be deemed to be mitigation for ongoing impacts of system-wide diversions and impacts, and should to be paid for from revenues of a system-wide water user charge.
- Public funding is appropriate for part of the planning process, but public funds must be reimbursed by the contractors for those facilities. Some amount of user funding should supplement the public funds in the early planning process, as an indication of eventual user interest in the facilities.