Friant WATER AUTHORITY

Remote Attendance

City of Fresno - 1626 E Street, Fresno 93706
Fresno I.D. – 2907 S. Maple Ave, Fresno 93725
Hills Valley I.D. – 12201 Ave 480, Orange Cove 93646

SPECIAL BOARD OF DIRECTORS MEETING

MONDAY, AUGUST 12, 2024
8:30 A.M.
LINDSAY CONFERENCE ROOM
854 N. HARVARD LINDSAY, CA 93247

CALL TO ORDER/ROLL CALL – (ERICKSON)

APPROVAL OF THE AGENDA – (ERICKSON)

OPEN SESSION

1. ACTION ITEM

A. Establishment of an Updated Cost Share Methodology for the Friant-Kern Canal Middle Reach Capacity Correction Project and Provision of 60-day Notice to Friant-Kern Canal Contractors.

ADJOURN TO CLOSED SESSION (If Necessary)

2. CLOSED SESSION

A. CONFERENCE WITH REAL PROPERTY NEGOTIATORS
(Government Code section 54956.8)
Property: Friant-Kern Canal facilities and right-of-way
Agency negotiator: CEO, COO, CFO, General Counsel
Negotiating parties: United States (Bureau of Reclamation)
Under negotiation: Middle Reach Capacity Correction Project Cost Share Agreement (price and terms of payment)

ADJOURNMENT

PUBLIC PARTICIPATION INFORMATION

Under the Americans with Disabilities Act, if you require a disability-related modification or accommodation to participate in this meeting, including auxiliary aids or services, please contact Vivian Garcia at 559-562-6305 or vgarcia@friantwater.org prior to the meeting.

Agenda Report

No. 1.A

DATE: August 12, 2024

TO: Board of Directors

FROM: Jason Phillips, CEO; Wilson Orvis, CFO

SUBJECT: **Proposed Cost Recovery Methodology for any Cost-Share Deficit for the Middle Reach Capacity Correction Project**

SUMMARY:

In accordance with the Cost Share and Contributed Funds Agreement ("Cost-Share Agreement") between the Friant Water Authority (FWA) and the Bureau of Reclamation (Reclamation) for the Middle Reach Capacity Correction Project (Project) and the associated "Repayment Agreement", FWA is responsible for providing 50% of the up-front Project costs from non-federal sources and, after substantial completion, is responsible for repayment of the reimbursable federal share of the Project costs. The Project has been split into two phases:

- Phase 1 is currently estimated to cost $326.2 million, of which there is a projected:
  - Cost-share deficit during construction of approximately $5.1 million; and
  - Repayment Obligation of approximately $90 million (~$4 million / year in debt service for 30 years)

- Phase 2 is currently estimated to cost $247.2 million, of which all of the non-federal funding required to proceed has yet to be secured.

FWA's funding plan for the Phase 1 provides for $50 million in collections from the Friant-Kern Canal (FKC) Contractors, funding from the State, and the balance of the cost-share derived from revenues from Settlement Agreements executed with the Eastern Tule Groundwater Sustainability Agency (ETGSA) and the Pixley Groundwater Sustainability Agency (Pixley GSA). Pixley GSA made a full lump sum payment of $11 million under its Settlement Agreement. ETGSA did not provide the $125 million lump sum payment to FWA under the Settlement Agreement. To date, the revenues under ETGSA's alternative obligation to collect and remit to FWA up to $200 million under its transitional pumping penalty program have been substantially lower than expected. Additionally, it appears increasingly unlikely that the manner in which the ETGSA is implementing the transitional pumping penalty program will provide sufficient revenues to cover the remaining Project cost obligations. As a result, without additional revenues, FWA is anticipating a cost-share deficit for the Project during the remainder of construction and an additional, more substantial deficit to meet the annual debt service payments under the Repayment Agreement.

Reclamation is aware of FWA's projected cost-share deficit for the Project and, in recent meetings, has asked that FWA make a determination on the cost recovery methodology for the deficit as soon as possible as it will affect several matters including future funding/Phase 2+ decisions.

After incorporating input received at the July 25, 2024 Board meeting and conducting further analysis, FWA staff have developed a recommended cost recovery methodology for the anticipated funding deficit for the Project. The rationale for this recommendation as well as the proposed provisions of this cost recovery methodology are provided below. In accordance with Article 12 of the Transfer Agreement between FWA and Reclamation, any new, proposed OM&R cost recovery methodology requires FWA to provide notice to all affected contractors for at least 60-days prior to the effective date of the cost recovery methodology.

Staff is requesting that the Board of Directors make a determination on the cost recovery methodology to be used in the event there is a deficit of available funding to cover outstanding costs associated with the Middle Reach Capacity Correction Project so that the methodology can be submitted for the 60-day review period.

COST RECOVERY OPTIONS:

FWA staff identified the following four options for cost recovery for any future Project deficits.

- **Option 1 – Default**. This option represents a scenario in which the Board takes no action on how to collect funds for repaying Reclamation for money owed under the Cost-Share Agreement, and FWA informs Reclamation that it is unable to make the required payments. As a reminder, if the Board, after good faith efforts to agree upon an updated cost recovery methodology, including seeking alternative sources of funding, is unable to do so, then the default provision of Section IV.E.i. of the Cost Share Agreement would apply, which provides that Reclamation will step in and assist in securing a third-party contributor. If Reclamation does so, the resulting loan must be repaid within 5 years with interest incurred by the contributor plus four percent and have priority for repayment from all sources of funding for the Project. (Note – based upon previous feedback from the Board of Directors, the "Default/No-Action" option was determined to be non-viable as it still requires the Board to determine a cost recovery methodology for the loan repayment.)

- **Option 2** – **"Family Plan" Alternative.** Under this option, the Board would allocate any future Project funding deficits using the existing OM&R cost allocation methodology (25-year rolling average of all deliveries), effectively increasing the Friant-Kern Canal (FKC) Contractor contributions to the Project beyond the current $50 million ceiling.

- **Option 3** –**Direct Beneficiary Alternative.** Under this option, the Board would allocate any future Project funding deficits to FKC Contractors using an agreed upon cost allocation methodology that considers direct benefits of the Project.

- **Option 4** – **ETGSA District Alternative.** Under this option, the Board would allocate any future Project deficits to those FKC Contractors within the boundaries of the Eastern Tule Groundwater Sustainability Agency (ETGSA).

STAFF RECOMMENDATION AND RATIONALE:

As a general matter, when recovering costs associated with the operation, maintenance and replacement (OM&R) of existing project facilities, including full replacement or extraordinary maintenance (XM), the traditional methodology to recover such costs would be to spread the costs among all those that benefit from the original project in proportion to the amount each entity would be benefitting from the entire project. The rationale being that contractors should only receive the expected benefits from the project so long as everyone contributes proportionally to the entire project being kept in a condition to deliver the originally intended benefits to all contractors. This is especially true when any particular OM&R project does not result in new benefits exceeding the originally authorized project. If a project is not able to be maintained to deliver the benefits to all contractors as intended, presumably the delivery of water may need to be revised to ensure the benefits are still being distributed equitably.

However, the situation is different if an OM&R project is necessary due to damage caused by actions of known entities. In these circumstances, the recovery of costs for the project should be guided by the equitable principle to collect from the entities that caused the damage, and only seek to recover funds from other contractors if collecting the full project costs from the damaging entities is not possible. In the case of the MRCCP, it is well-established that the project is necessary due to land subsidence along the Middle Reach of the Friant Kern Canal (FKC) resulting from the excessive groundwater pumping taking place within the Tule Subbasin. At the outset of the Project, FWA prepared an analysis that demonstrated that, if unmitigated, the future additional subsidence along the FKC caused by continued excessive groundwater pumping in the Tule Subbasin would result in water supply impacts in excess of $265 million in 2020 dollars. As such, an equitable approach for recovering the costs of the MRCCP would be for the landowners within the areas covered by Tule Subbasin Groundwater Sustainability Agencies (GSAs) to be allocated all of the project costs, as they are the sole beneficiaries of the overdraft groundwater pumping causing the subsidence along the FKC. With that objective in mind, FWA pursued recovering costs from certain Tule Subbasin GSAs through negotiated settlement agreements. As a result of the negotiations and other factors, the FWA board decided that the collection of a lump sum payment of $125 million by December 2022, or up to $200 million over time by ETGSA, and a lump sum payment of $11 million from Pixley GSA by December 2021, along with funding from others, would result in an equitable recovery of costs for the MRCCP.

The landowners in Pixley GSA have already paid their allocated share in full. It appears highly unlikely, however, in part for reasons currently under litigation, that landowners in ETGSA will pay sufficient penalties or other charges to ETGSA to cover the share of the MRCCP allocated to this area. This is in spite of the fact that overdraft groundwater pumping along with its subsidence inducing damage is continuing at a rate that is substantially higher than originally projected, while the financial benefits of this pumping as well as the related water credit and transitional water trading continue to accrue to landowners in the area covered by ETGSA. If landowners in the ETGSA are not charged and therefore do not pay substantially more penalties or other charges than they have since 2021, FWA will have a sizable deficit owed to Reclamation and will need to take action to collect from the FKC Contractors to cover the difference.

Recommended Cost Recovery Methodology.

FWA staff recommends the following cost recovery methodology for the remainder of the MRCCP costs, including Phase 1 and any project work that proceeds under Phase 2.

> “**Middle Reach Capacity Correction Project Cost Recovery Methodology**
> If and when any cost obligations related to the MRCCP are due by FWA and FWA has insufficient revenues to cover the amount due, FWA will assess and collect the full amount due from the four FKC Contractors within the ETGSA boundaries (Porterville ID, Saucelito ID, Terra Bella ID, and Tea Pot Dome WD), subject to the following:
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> - The recovery of any costs between Porterville ID, Saucelito ID, Tea Pot Dome WD, and Terra Bella ID will be on the basis of irrigable acreage.
> - The amount recovered under this methodology, when combined with the total amount received from ETGSA under the Settlement Agreement and any separate agreement(s) with ETGSA District(s), will not exceed $200 million.
> - Subject to Board approval, any FKC contractor within the ETGSA boundaries can enter into a separate agreement with FWA which may include, but is not limited to provisions that address payment of their equitable share of the Project costs which recompenses FWA for the District landowners actions that resulted in unmitigated non-sustainable groundwater pumping, a framework to ensure that the District’s landowners properly mitigate for any actions that contribute to non-sustainable groundwater pumping, and any other provisions the Board finds necessary to ensure the District takes all reasonable actions to mitigate for the activities of its landowners as it relates to the impacts to the Friant-Kern Canal.

FWA staff believes that the recommendation is equitable due to the fact that the landowners in the FKC contractor districts within ETGSA receive the potential benefit of transitional overdraft pumping and are able to engage in the beneficial transfer and sale of groundwater credits as well as transitional overdraft water allocations. These districts also have significant control over the actions of the ETGSA Board of Directors. Further, as ETGSA distributes groundwater allocations and credits based upon irrigable acreage to all landowners, the relative allocation of costs between the four FKC contractor districts is on the same basis. If ETGSA during any period is able to collect and remit to FWA enough funds to pay the then current FWA repayment obligation, no costs will be assessed to these four FKC contractor districts under this cost recovery methodology.

SUGGESTED MOTION:

I move that the Board of Directors approve the staff recommended (Option 4) MRCCP Cost Recovery Methodology, effective October 12, 2024, and direct staff to provide notice of the MRCCP Cost Recovery Methodology to all affected Friant Division Contractors and Reclamation.

ATTACHMENTS

- None.