

Diversified Water Supply Sources Central to Staying Prepared for Long-Term Needs

Background

With more water available, 2016 was much less stressful than the prior couple of years. It rained a little more, snowed in the mountains and was just cold enough to keep the snowpack intact long enough to provide water for the state's reservoirs in the spring and summer months. The drought isn't over; it's just not as severe. The northern part of the state is recovering, but the Central Valley, Central Coast and Southern California still are designated as in an extreme or exceptional drought status. The new water year started out with a wet October but segued into a dry November. It is impossible to predict what kind of water year 2016–2017 will be, so it is reasonable to prepare for another dry winter.

The previous year showed that everyone could conserve water. When the Governor imposed mandatory water conservation measures in 2015 to reduce potable urban water usage by 25% of 2013 levels statewide and imposed curtailments of farmers' water rights, business, agriculture, water districts and residents stepped up and turned off the water spigot. Lawns turned brown, cars stayed dusty, new drought-resistant landscaping cropped up, businesses looked for innovative ways to reduce water usage, and farmers found ways to grow using less water.

Because there was more water available in 2016, mandatory water conservation measures were lifted mid-year in favor of requiring water districts to undergo a stress test to show that they had a three-year source of water. Most of the districts were able to meet the requirement. Once the requirement was met, some water districts stopped their conservation measures, but many others modified them, keeping in place such measures as two-day-a-week outdoor water schedules and no hosing down driveways. When lifting the mandatory conservation measures, the Governor told the state agencies involved with water to develop a long-term plan to improve conservation in the state. Two other major benefits of more water in the system were that senior water rights holders on the main rivers and tributaries were not subject to curtailments and there was no need to provide a barrier to salt water intrusion into the Sacramento-San Joaquin Delta.

The State Water Resources Control Board (SWRCB) released its long-anticipated draft proposal to update the water quality requirements for salinity in the South Delta and new flow objectives for major tributaries of the San Joaquin River for fish, causing an outpour of heated comments. SWRCB also released a working draft proposal for the Sacramento River flow objectives that was equally controversial.

Meanwhile, the Governor's proposed twin tunnels project proceeded. The long process of public hearings before the SWRCB commenced mid-2016 and likely will go on for many more months, well into 2017. The first set of hearings were about the

Department of Water Resources petition for new water intakes and what if any injuries to other water users, flood protection and environmental justice would occur. The second set addresses fish and wildlife, recreation, and other public trust issues.

In December 2016, just before the statutory deadline, the California Water Commission adopted regulations defining what constitutes public benefits for water storage projects seeking funding from Proposition 1, the Water Quality, Supply and Infrastructure Improvement Act of 2014. A variety of storage proposals already are cued up pending finalization of the regulations.

The U.S. Environmental Protection Agency continues to pursue expanding its jurisdiction over more water bodies, resulting in more regulations under the Clean Water Act. In December 2016, U.S. Senator Dianne Feinstein (D-San Francisco) and Congressman Kevin McCarthy (R-Bakersfield) made a last-minute maneuver inserting language into a bill that would give California federal drought relief. The bill passed the U.S. House of Representatives and U.S. Senate by healthy margins and was signed by President Barack Obama on December 16, 2016.

Conditions at End of 2016

California is chronically short of water, even in normal years. But after five dry years, parts of the state remain in extreme to exceptional drought status (see map). Most of the rain in 2016 fell in the far north region of the state, while much of the need is in the coastal, central and southern portions of the state.

Weather forecasters initially believed that 2016–2017 would be a dry winter based on a La Niña system prevailing in the Pacific Ocean. However, their prediction of a wet winter for 2015–2016 never materialized. So while the beginning of this water year has been significantly wetter than average, it's far too early to know what kind of water year will ensue. Some areas of the state could remain dry. What is known is that it will take a series of wet years and mild to normal summers to break the ongoing drought statewide. Rain is certainly an important factor to break the drought, but real relief comes down to the amount of snowpack in the Sierra Nevada mountain range. The eight-station index in the Northern Sierra has been running far below average for the last few years, but shows the first sign of recovery this winter. The snowpack from these areas fills reservoirs during the spring snow melt.

Many major reservoirs, lakes and dams around the state ended 2016 on the low side, but a few are slowly beginning to come around. In the north, Shasta Reservoir was at 74% of capacity at the end of 2016—up from 34% at the end of 2015; Folsom Lake was at 42% compared to 28% the previous year; and Lake Oroville was at 56% compared to 30% the previous

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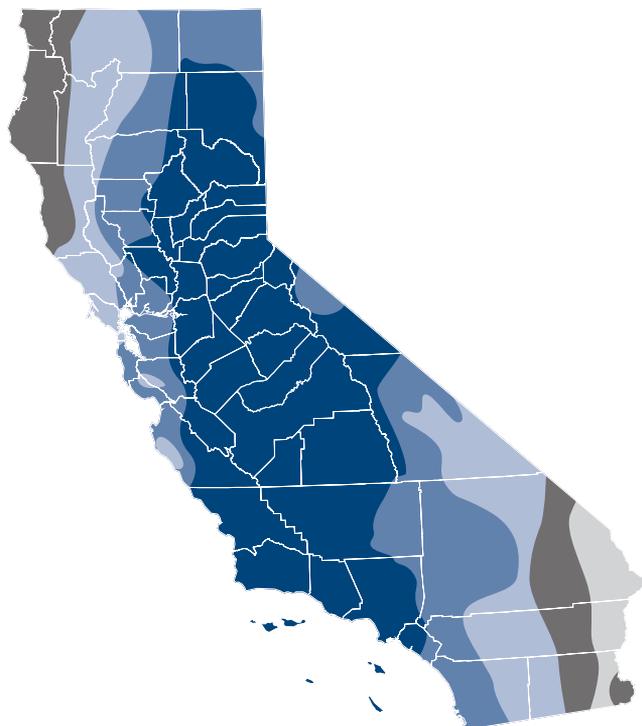


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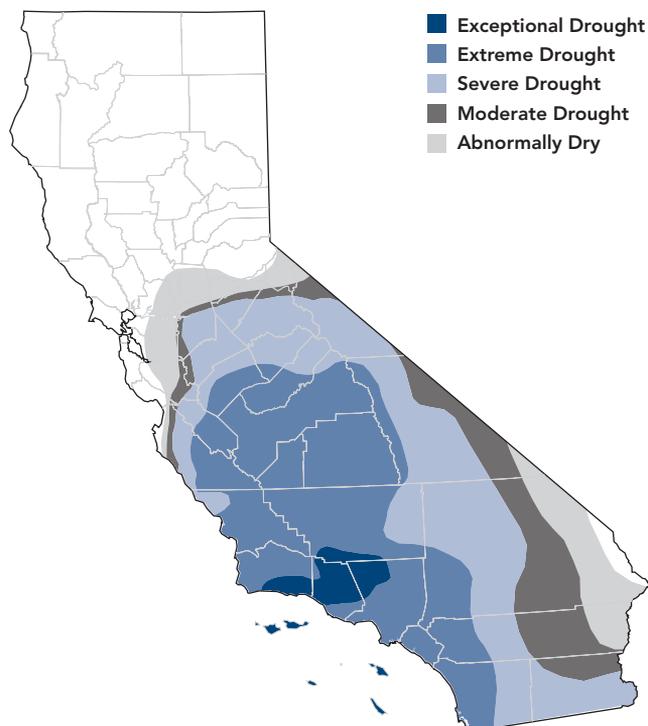
California Drought Comparison 2016 vs. 2017

Released Thursday, January 7, 2016



Source: The National Drought Mitigation Center

Released Thursday, January 10, 2017



year. Moving toward the middle part of the state, Don Pedro Reservoir was at 74% compared to 36% the previous year, New Melones was at 26% compared to 14% the previous year, and San Luis Reservoir was at 60% compared to 27% the previous year. In the southern part of the state, Diamond Valley Lake was at 70% of capacity compared to 39% the previous year, Perris Lake was at 38% compared to 36% the previous year, and Castaic Lake was at 54% compared to 38% at the end of 2015.

While reservoir levels are higher than last year, once again it is important to note that the most significant factor will be the snowpack in the Sierra Nevada mountains. The eight-station index is showing positive signs for the beginning of the 2017 water year with an observed 168% of average.

The new water year began October 2016 with 4.9 million acre-feet of water in six key federal Central Valley Project (CVP) reservoirs. While it is 2 million acre-feet more than what the CVP began with last year, it still is far below the 15-year average carryover of 6.4 million acre feet. One acre-foot is enough water to cover one acre of surface area to a depth of one foot and is enough water for a family of four for one year.

The CVP, operated by the U.S. Bureau of Reclamation, is one of the world's largest water storage and transport systems. Its 22 reservoirs have a combined storage of 11 million acre-feet, of which 7 million acre-feet is delivered in an average year. In comparison, the California State Water Project's (SWP) 20

major reservoirs can hold 5.8 million acre-feet, with annual deliveries averaging up to 3 million acre-feet.

The CVP typically provides irrigation water critical to about 3 million acres of agricultural land in the San Joaquin and Sacramento valleys and along California's Central Coast, but that was significantly reduced in 2014 due to drought conditions. The CVP also provides urban water for millions of people and industrial water essential to the San Francisco Bay Area's economy and for the environment, wildlife, fishery restoration and hydroelectric power production.

Similarly, the SWP stores water and distributes it to 29 urban and agricultural water suppliers in Northern California, the San Francisco Bay Area, the San Joaquin Valley, the Central Coast, and Southern California. Of the contracted water supply, 70% goes to urban users and 30% goes to agricultural users. The SWP provides supplemental water to approximately 25 million Californians and about 750,000 acres of irrigated farm land. The SWP is beginning the water year in far better shape than last year with just over 85% of total average storage. Together the two projects are the backbone of the state's water system serving cities and farms.

Drought

The ongoing and persistent drought has changed the water landscape in California. Even though 2010 and 2011 were wet

precipitation years, and 2015 was wetter than previous years in parts of the state, not enough rain and snow fell to recover storage levels. 2014 was the third driest in 119 years of records and 2015 continued the drought cycle. There is no real relief for the state in wet years because California is chronically short of water, even in normal years, which the state has not had in more than five years. The only way to resolve the chronic shortage is to move forward with a comprehensive, long-term fix for the Delta, which is how water is moved around the state, plus increased storage and conveyance capabilities. Reuse, recycling, desalination, and conservation are all necessary tools to complete the water strategies for the state. Preparedness through diversification is how to ensure California has an adequate water supply.

Initial water allocations for 2017 are 20% of the requested contract amount from the SWP. Initial allocations for 2016 also were 10% of the contract amount, but increased to 60% from a wetter-than-anticipated winter. The allocation is always conservative, because it doesn't reflect that the state normally receives more than 90% of its snow and rain from December through April. The initial forecast of the CVP water supply allocations for the contract year (which begins March 1) will be made in February. Allocations will be adjusted monthly or more often to reflect the updated snow pack and runoff. The April 1, 2016 data from the CVP indicates that contractors north of the Delta received 100% of their allocation, and allocations south of the Delta ranged from 5% to 55% for agriculture and urban respectively.

While higher than last year, water levels in some reservoirs remain low throughout the state. Even if the state were to have a very wet winter, it would not be enough to recover because many of the state's dams and reservoirs serve a dual purpose of water storage and flood control and can't be allowed to fill completely. As noted in a February 2016 *Sacramento Bee* article, "Federal dam operators recently increased the flows out of Folsom Lake by thousands of acre-feet a day as a precaution against flooding. They did so even as the reservoir sat 40% empty." The operators were simply adhering to a 30-year old manual by the U.S. Army Corps of Engineers that requires Folsom Lake to release water when the lake level rises to a specific height. This is done in order to ensure that there is sufficient room in the lake to buffer any storms that may occur. If no storms occur after the increased release, however, the water was simply moved for no reason. These requirements, combined with court-ordered cuts in water deliveries, slow groundwater recovery, and limited storage capabilities create challenges for all of California's water users.

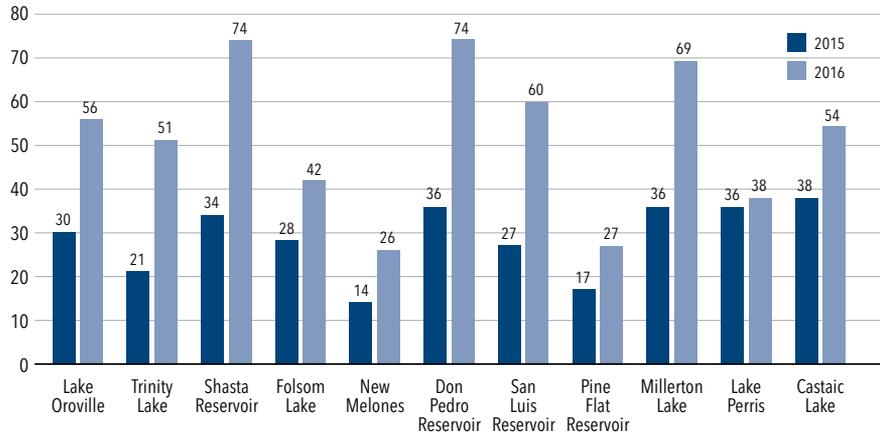
Changed Conditions

When the State Water Project (SWP) was constructed, the population was about 15.85 million. The SWP was designed to supply water for the next 25 million people, bringing the population to about 40.85 million by 2040. According to the California Department of Finance, California's population passed 39 million in 2015, surpassing the population growth models used in the SWP almost 26 years earlier. California has less water available due to the reduced draw from the Colorado River per legal agreement, a court settlement requiring restoring water flows to dry parts of the San Joaquin River, Owens River watershed and the CVP due to environmental reallocations. There are many more restrictions on how water is moved within the state, especially through the Sacramento-San Joaquin Delta. Many in the environmental community contend that climate change threatens to make future droughts even more severe.

For the first time in 75 years, in 2015 the State Water Resources Control Board (SWRCB) imposed restrictions called curtailments on some of the most senior water rights

Reservoir Levels Higher

% of capacity at end of year

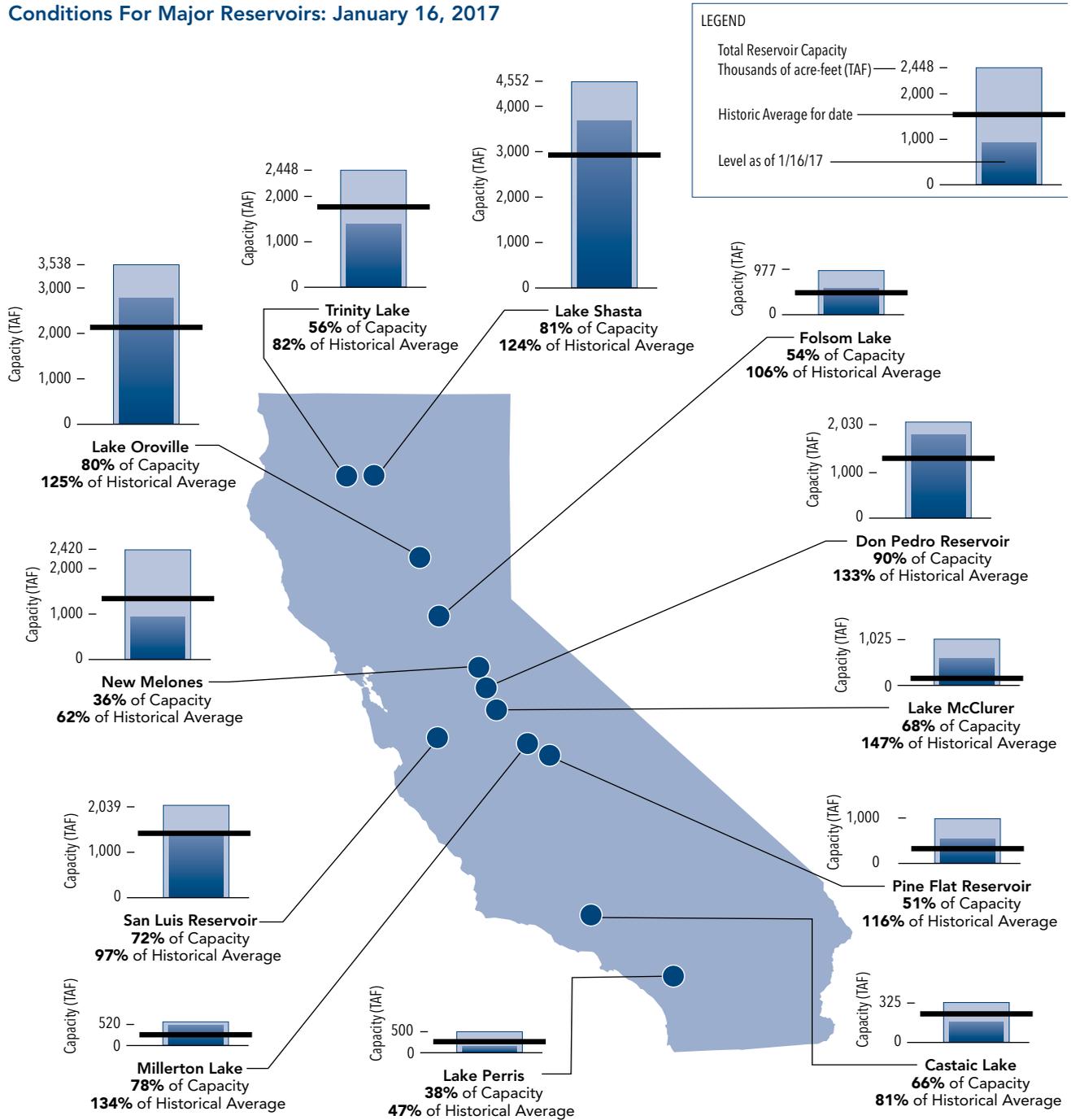


Source: California Department of Water Resources

holders, those with pre-1914 rights. The order affected 276 rights held by individuals and several agricultural water districts, amounting to 1.2 million acre-feet of waters. Curtailments had been imposed on the junior rights holders in 2014 and 2015 to ensure senior water rights holders would have access to water during the drought, a requirement of state law that governs water rights priorities. More than 10,000 holders of "junior" water rights—those awarded after 1914 and another set awarded after 1953—were required to cease diverting water from certain rivers and streams. Water rights holders can be individuals, cities, counties or water districts. Curtailments were lifted late in the year, but can be reinstated if nature does not provide enough water.

Because there was more water available in the system,

Conditions For Major Reservoirs: January 16, 2017



Source: California Department of Water Resources

curtailments were not needed in 2016, when SWRCB held back even more water than in 2015 at Shasta Reservoir in an effort to save the endangered winter-run Chinook salmon. It appears that this approach had positive impacts on the salmon run. Figures released by the federal government show that about twice as many winter-run salmon were counted in the Sacramento River by late 2016 compared to 2015, and the percentage of fish

killed by river conditions fell dramatically.

Winter-run salmon require cool water—56 degrees or cooler—on the Sacramento River. If the temperature rises too high, the eggs and juveniles die off. Salmon have a three-year spawning cycle, which places them in jeopardy considering the die-off from 2014 and 2015.

Holding back larger amounts of water in Shasta Lake is seen

as successful for the salmon this year, but it means less water for downstream farmers and cities. Business and agricultural representatives commented that this year's plan was too rigid and could deprive them of sorely needed water supplies if the same plan is implemented in the future.

Mandatory Conservation Measures

Water conditions improved enough so that in May 2016 Governor Brown suspended the mandatory statewide conservation measures he imposed in 2015 with the proviso that they could be reinstated if conditions worsened. He also directed state agencies to prepare a plan to achieve long-term efficient water use and drought-preparedness goals. The draft plan's fundamental premise is that efficient water use helps all of California better prepare for longer and more severe droughts caused by climate change.

Some of the actions in the draft plan will require legislation for new and expanded state authority. The plan represents a shift from statewide mandates to a set of conservation standards applied based on local circumstances, including population, temperature, leaks and types of commercial and industrial uses. For instance, communities in hotter and drier climate zones will receive irrigation allowances that reflect evaporation levels. Cities have until 2025 to fully set and meet the budgets, and risk state enforcement if they fall short.

Key Points of Draft State Water Plan

- Permanent bans on wasteful practices, such as hosing driveways and excessive landscape watering.
- Technical assistance and financial incentives for water suppliers to implement leak prevention, detection, and repair programs.
- Collecting information about innovative water conservation and water loss detection and control technologies.
- Requiring agricultural water suppliers to quantify water use in their service areas and describe measures to increase water use efficiency.
- Cities and counties must have draft contingency plans for droughts up to five years (three years is the current stress test level).
- Full compliance with water use targets for urban water suppliers by 2025.
- Planning and preparing for continued and future drought and water shortages.

The draft plan leaves many of the finer details of carrying out conservation proposals to be worked out. Initial statements from the business community are favorable and recommend a technical working group to help develop a board framework for compliance when dealing with the commercial, industrial and institutional sectors. The comment period closed in December and the final plan is expected to be adopted sometime in January 2017. At the same time, the State Water Board will consider whether it must extend its existing emergency water conservation regulations as required by the Governor's recent executive order. The SWRCB already took action to maintain mandatory reductions in

communities that could not verify they have enough water to withstand three more years of severe drought.

Costs of Drought

California lost more than 1,815 full- and part-time jobs in the agricultural sector and approximately 80,000 acres were fallowed as a result of water shortages in 2016, according to the University of California, Davis. Economic losses are estimated at \$247 million of farm-gate revenues. Those losses were concentrated in the Central Valley south of the Delta. When spillover effects to other sectors of the economy are considered, the estimated total loss is about \$600 million and 4,700 full- and part-time jobs statewide due to drought in agriculture. Despite the drought, overall agricultural value and employment grew statewide.

As the price of water increases, the profit margin for water-intensive business enterprises decreases, creating an uneven playing field for California businesses such as agriculture, chip manufacturers, breweries, utilities and hospitals.

Ultimately, cyclical or ongoing droughts will result in higher production costs for businesses, more pressure on the state's groundwater resources, higher prices for produce and other food products, and explosive fire seasons that will be hard to combat, given limited resources—especially water. California's 2016 fire season saw about 6,898 fires burning approximately 559,916 acres (combined Cal Fire and U.S. Forest Service numbers), which is very costly to fight in terms of water and budget pressures. So far, 102 million trees have perished from drought conditions, adding significantly to the fuel load in the forests. Ancillary to the cost of fighting fires is the cost to prevent mudslides in areas denuded of vegetation.

Prices continue to rise, much to the dismay of ratepayers, because using less does not mean paying less, as the fixed costs of buying and delivering water, and maintenance and operations costs must be met regardless of much water is used. Looking into the future when droughts will continue to be cyclical, many localities are expected to step up local conservation with new rules and stronger enforcement. Further exacerbating the issue is that much of the piping carrying drinking water and sewage is aging and must be replaced in order to meet tightening water quality standards.

Outdoor watering restrictions burden the warmer parts of the state, such as the Central Valley, causing a trade-off of less water usage but increased energy costs as a result of operating air conditioning when temperatures are in the 100s for days at a time. Trees and lawns keep temperatures more moderate and provide defensible space as required by fire safety rules.

Proposition 218

In general, the intent of Proposition 218 (passed in 1996 to amend the California Constitution by adding Articles XIII C and D) is to ensure that all taxes and most charges on property owners are subject to voter approval. Voters also were given the ability to reduce or repeal charges by voter initiative. In the case of benefit

assessments, benefits must be calculated based on the benefit received by the parcel. Water districts are subject to Proposition 218 when setting rates. A recent court decision ruled that a water district incorrectly imposed a tiered rate structure penalizing higher tier users without showing the relationship of the tier to the cost to the district of providing the water.

One of the Governor's mandated conservation measures is implementation of conservation pricing: Use more, pay more. The difficulty for water districts is showing the conservation measures' benefit per parcel as required by Proposition 218. Most local agencies handle changes in rates by mailing notices to each parcel owner giving information about the rates and the reasons for the changes. If the majority of constituents protest the changes, the district cannot impose them.

Looming on the horizon is the State Water Board strategy of using stormwater as a water supply source, which would require an affirmative vote of the people to impose because it is a new assessment not covered by Proposition 218. The SWRCB started Phase 1 of a three-phase project stretching over four years by contracting with the California State University, Sacramento Office of Water Programs to provide a stormwater capture and use report. Additionally, the Governor has been vocal about the need to provide lifeline rates for low-income users, which cannot be blended into a rate increase for all ratepayers as there would be no equitable benefit per parcel.

At the end of 2015, a coalition including the Association of California Water Agencies, the California State Association of Counties and the League of California Cities filed a constitutional amendment initiative that would create a new, optional funding method local agencies could use at their discretion to finance stormwater, flood control and other water- and sewer-related projects, and pursue conservation-based water rates or lifeline rates for low-income households. The measure was submitted to the Attorney General's office for title and summary as a potential statewide ballot initiative. The measure would amend Article X of the California Constitution, which deals specifically with the management of the state's water supplies. The proposed amendment seeks to create an optional funding method in Article X while preserving the ability for public agencies to continue establishing rates under existing law found in Article XIII D. The proponents did not pursue the initiative or a legislative fix in 2016.

Groundwater: The New Frontier

Unlike almost all other Western states, California never has had a comprehensive system for regulating groundwater. A body of common law grew that governs extraction and use of groundwater. Management generally has been in the form of plans developed by local agencies that focused primarily on information gathering. Farmers and other groundwater users have pumped at will without having to obtain government approvals.

Changing demands over time—like shifting to more water-intensive crops, new environmental restrictions on the

availability of surface water, and increased urban usage—have resulted in chronic overdraft and noticeable increases in soil subsidence (permanent loss of below-ground storage capacity) in many basins and sub-basins. Just about everyone agrees that something has to be done to prevent further losses.

The Legislature passed a comprehensive groundwater management package of bills in the waning days of the 2013–2014 session. Three bills taken together—SB 1168 (Pavley; D-Agoura Hills), SB 1319 (Pavley; D-Agoura Hills) and AB 1739 (Dickinson; D-Sacramento)—enacted the Sustainable Groundwater Management Act (SGMA). The bills were developed over several months by legislative consultants and included many meetings with stakeholders. The process was very challenging for all parties with many versions of the bills in circulation at the same time. The organization of the bills is confusing with many ambiguous provisions. It is a foregone conclusion that litigation will ensue and unintended consequences are inevitable.

Key Provisions

- Each groundwater basin or sub-basin will be regulated separately. There are 127 of them designated as “high” or “medium” priority by the Department of Water Resources (DWR) that will be required to comply with the Act. “Low” and “very low” priority basins may be considered later.
- Existing local agencies overlying each basin will be given both the mandate and a broad array of tools to regulate groundwater in their basin or sub-basin. Key among those tools is the ability to limit extractions and to impose fees related to groundwater use.
- The goal of regulation will be to achieve “sustainability.” Sustainability generally means bringing the basin or sub-basin into balance by eliminating overdraft. Local agencies will make that determination based on local conditions.
- For portions of regulated basins not served by existing local agencies, the county overlying will be the default agency unless landowners quickly form a new local agency.
- For basins or sub-basins covered by multiple local agencies, those agencies must coordinate their individual plans, or form a joint powers authority or some similar mechanism to develop a single plan for the basin or sub-basin.
- For basins or sub-basins in which regulation is mandatory, deadlines will be established for local agencies to assume the groundwater regulation role by July 1, 2017 and to adopt a “groundwater sustainability plan” by January 31, 2020 in some basins and January 2022 for others. If those deadlines are missed, or if DWR determines that a plan is not adequate or cannot achieve the sustainability goal, the State Water Resources Control Board will have the authority to impose its own “interim” plan until an acceptable local plan is in place.
- Groundwater sustainability plans and progress toward meeting the sustainability goal will be evaluated every five years.
- Plans will not establish or determine groundwater rights. They will govern how those rights are exercised.

- Metering and reports of groundwater use will likely be required from each groundwater user.

The SGMA does not mandate groundwater pumping restrictions or require the imposition of groundwater fees, but allows both. It's hard to imagine the basins or sub-basins achieving sustainability without imposing some sort of pumping restrictions or limitations. Looking at the amount of work needed to design plans to achieve basin sustainability and then to implement the plans, fees are going to be necessary.

The question of “grandfathering” existing wells or historical uses is largely unaddressed in the legislation. Those are important issues in adjudication actions. If the plans become too cumbersome or burdensome, it is very likely that there will be movement toward adjudication. It is important to reiterate that the SGMA does not establish, determine or confirm water rights. It regulates the exercise of those rights. However, adjudication will establish or determine water rights.

Two issues of importance were resolved in 2015. A streamlined adjudication process supported by business and agriculture was adopted that reduces the burden of groundwater adjudications on both the courts and claimants without altering the law of groundwater rights and without disrupting the SGMA. Second, DWR implemented new basin boundary regulations that effectively give local agencies an additional six weeks to prepare their requests for any basin boundary changes. Also, DWR established a new web-based reporting system that allows local agencies to submit basin boundary modification requests and provides public access to view the information. Much of 2016 was consumed with basin boundary modification requests and creation of groundwater sustainability agencies, which has proven to be very controversial.

Bay Delta Conservation Plan aka California WaterFix

The Bay Delta Conservation Plan (BDCP) was a key part of the 2009 comprehensive water package that addressed California's long-term water strategy. It is a 50-year, ecosystem plan to restore fish and wildlife species in the Delta in a way that provides for the protection of reliable water supplies while minimizing impacts to Delta communities and farms. The BDCP has been the works for more than seven years. It focuses on the Sacramento-San Joaquin Delta, where water is diverted to serve 25 million Californians and 3 million acres of farmland.

One of the most controversial elements of the plan is the proposal to construct two tunnels that have the capacity to move 9,000 cubic feet of water per second, which is much lower than an earlier proposal of 15,000 cubic feet of water per second. The tunnels would divert a portion of the Sacramento River's flow at three intakes proposed near Courtland, routing the water to existing diversion pumps near Tracy. The goal is to avoid reverse flows in the estuary caused by the current diversion pumps, which are one cause of ecological trouble in the Delta. The new intakes also would have modern fish screens, which the current intakes do not. The proposed tunnels are routed to

the east side of the valley to reduce impacts to the Delta. The BDCP described and analyzed 15 alternatives, but the twin tunnels alternative was the preferred alternative.

Critics caution that the new intakes simply move the harm to endangered fish species to a different part of the estuary, damage the Delta as a community and potentially jeopardize the agricultural economy. Proponents warn that one big earthquake in the Delta would leave 25 million people living south of the Delta with very limited water supplies.

The mandated Environmental Impact Report/Environmental Impact Statement (EIR/EIS) was released for public comment in late December 2013 and closed in July 2014. A Draft Implementing Agreement also was circulated for 60 days ending in July. Thousands of comments regarding the twin tunnels alternative led to the state and federal agencies deciding to make changes and recirculate the environmental documents in April 2015 with the comment period closing in October 2015.

The biggest change was in Alternative 4 and the twin tunnels. The new Alternative 4A includes the conveyance facilities proposed under Alternative 4, but does not include the elements of a habitat conservation plan, which is now separate and embodies a different regulatory approach for gaining necessary permits and authorizations for implementation under the state and federal endangered species acts.

In January 2016, DWR announced the establishment of a Joint Powers Authority comprised of public water agencies that guide how DWR will collaborate with local agencies on the design and construction of WaterFix, if government agencies approve permits and public water agencies vote to fund the project.

DWR asked for the addition of three new points of diversion in the Sacramento-San Joaquin Delta for the WaterFix mid-year as a part of the tunnels project. The SWRCB started a series of public hearings to hear testimony and comments from interested parties regarding any injury to water users, flood protection and environmental justice issues from the proposed new diversion points. A second set of hearings will address fish and wildlife, recreation, and other public trust issues. The public hearings are scheduled to run through part of 2017.

Also, DWR and the U.S. Bureau of Reclamation submitted a revised biological assessment with the request to begin the formal consultation process under the federal Endangered Species Act, Section 7. The BDCP/WaterFix plan is moving along through the regulatory process, running a little behind schedule. EcoRestore, the companion habitat conservation plan, is moving toward construction of habitat restoration projects it announced in the early part of 2016.

'Stop Blank Checks' Initiative Fails

Proposition 53, the “Stop Blank Checks” initiative, failed to pass in November 2016. The initiative tried to do two things. It required California voter approval for state projects that would use more than \$2 billion in state revenue bonds, and before that

vote, it required a full disclosure of the total cost of any state revenue bond project great than \$2 billion.

These simple requirements placed the Delta tunnels project in peril. The heart of the project's financing scheme is the use of revenue bonds, repaid from users' water rates. A requirement for a public vote for a revenue bond for the Delta tunnels is akin to a statewide referendum on the project itself. Moreover, a future measure to authorize the revenue bond would require a "yes" vote to sustain the project, which traditionally is harder and more expensive to secure than a "no" vote.

The Governor was the lead opponent to the initiative, helped by a large coalition of business and labor leaders, including the California Chamber of Commerce, that ran a vigorous and successful campaign to stop Proposition 53.

Water Quality

SWRCB is in the process of updating the Water Quality Control Plan for the Bay-Delta to establish flow and water quality objectives needed to reasonably protect beneficial uses, including fish and wildlife. There are two proposals—one the San Joaquin River and its tributaries, and a second one for the Sacramento River and its tributaries.

The San Joaquin River proposal released in September 2016 immediately drew criticism from agriculture, business and water districts, and praise from the environmental community. The proposal recommends between 30% and 50% of the river's unimpaired flow be dedicated to fish. Average unimpeded flow is about 20% under current conditions. Staff suggested a starting point of 40%.

The issue, according to SWRCB, is that the San Joaquin River Watershed does not produce enough water to both meet existing human demands and support a healthy ecosystem. Requiring more water to remain in the river for the reasonable protection of fish and wildlife will reduce the quantity of surface water available for other uses. Implementing the flow proposal is expected to result in a 7% to 23% reduction in water available for human use. According the SWRCB, implementing the 40% flow proposal could result in an average increase in groundwater pumping of 105,000 acre-feet per year. The current deficit in groundwater supplies is about 45,000 acre-feet per year. Agricultural water supply deficits have the potential to increase over time as pumpers must come into compliance with the SGMA.

SWRCB staff estimated a \$64 million loss a year to agriculture. Farm groups believe the loss to be closer to \$150 million, idling possibly 240,000 acres of Central Valley farmland and significant job losses. Land values in affected parts of the valley will drop steeply with the loss of surface water depressing property tax and sales taxes revenues limiting county and city services to some of the neediest residents of the state. Businesses operating in the valley, especially small businesses, will be hard-pressed to survive under these conditions.

Water and irrigation districts told SWRCB the potential

loss of water supplies affects how districts will meet water conservation measures and groundwater sustainability goals. Business will be further adversely affected by the reduction in water supplies through higher costs to secure water and limitations on growth potential.

The Sacramento and Delta Flow Requirements are much less well-developed. A working draft was released in October 2016 with preliminary figures for unimpaired flow reductions ranging from 35% to 75% to improve habitat and provide flows that support native species and nonnative species. The draft is in the early stages and there will be opportunities for public participation and comment as the planning process moves forward.

Ideally, the SWRCB would like to negotiate voluntary reductions with water rights holders in advance of the final plans. That is unlikely as a number of water rights holders, water agencies and landowners have said publicly that they will challenge SWRCB's authority to impose cuts to their rights.

Water Bond

Proposition 1 – Water Quality, Supply and Infrastructure Improvement Act of 2014

Passage of Proposition 1 is a key element to the success of the state's long-term strategy to provide an adequate supply of water in future years. A water bond had been pending on the ballot since 2009 when a major package of bills was passed that laid out the inextricable linkages between the health of the Delta and California's statewide water supply management practices and policies.

The strategy covered governance for the Delta; put in place the Bay Delta Conservation Plan to restore fish and wildlife species in the Delta in a way that protects reliable water supplies while minimizing impacts to Delta communities and farms; mandated urban and agricultural management plans, recycling plans and new conveyance in the Delta. Passage of Proposition 1 was the last piece needed to complete the strategy.

The bond was much slimmer at \$7.5 billion than the original bond of \$11.4 billion, but funds investments in water projects and programs as part of a statewide, comprehensive water plan for California. Of keen interest to the business community is the \$2.7 billion for water storage capacity. It funds a share of new water storage projects to add flexibility to the state's water system and creates more places to store water in wet times for use later. Funding is not tied to specific projects; dollars are being allocated on a competitive basis to projects ranging from local and regional surface storage to groundwater storage and cleanup to reservoir reoperation. Bond funds are for "public benefits" of projects only, such as improved water quality, flood control and habitat restoration.

Storage was a critical component of the business community's support for the bond. Storage is needed to control the amount and timing of water flowing through the Delta to meet endangered species requirements, which affects

the amount of contracted water available for farms and cities downstream. It also provides the opportunity to store more water in wet years to offset needs in drier years. It may offset cutbacks already in place for the Delta smelt and salmon.

The bond not only provides funds for increased storage; it also provides funds for projects that lead to more reliable sources of water. For instance, cleaning up groundwater provides more local supplies. Increased recycling also increases the amount of water available for drinking water. Substituting recycled water for outdoor usage on landscaping, golf courses, parks, etc. could be a major water savings. Funds invested in strategies to treat wastewater to drinking water quality as is done in Orange County and contemplated in San Diego County are well spent.

The California Water Commission (Commission) is tasked with allocating the money among eligible projects. With input from the public and the aid of a stakeholder advisory group of which the CalChamber was a member, the Commission developed and adopted regulations in late December 2016. The regulations were submitted to the Office of Administrative Law (OAL) to start the process of finalizing the regulations. OAL could take up to a year to approve the regulations, but hopefully will act sooner. Project proponents have been tracking the work of the Commission in order to have their projects ready to meet requirements for consideration.

Federal Issues Pending

Drought Legislation

In a last-minute move before Congress recessed for the year, Senator Feinstein and Congressman McCarthy added a rider to S. 612, the Water Infrastructure Improvements for the Nation Act (WIIN), which passed the House and Senate and was signed by President Obama on December 16, 2016. S. 612 was amended to include the Water Resources Development Act of 2016, which contains traditional funding for water projects, and California drought legislation negotiated by Feinstein and McCarthy.

The drought language is very important to California. Of key importance are the provisions that balance the state's ability to move water at certain times of the year to benefit downstream users such as farmers, businesses and cities and still protect endangered species. The movement of water is critically important to combat drought conditions existing in the state.

The funding provided in S. 612 will promote local water supply development, water recycling and reuse, desalination and water storage projects. Expanding water storage is a top priority for the CalChamber. It is essential that the state has the ability to capture water in wet years or during storms, store it, and move it to areas in need, especially in dry years.

Also, the additional funding for loans and grants will help communities struggling with aging water infrastructure, dry wells and poor water quality. Expanding the existing Water Infrastructure Finance and Innovation Act to include drought mitigation projects will expedite much-needed infrastructure, especially in low-income communities.

Other provisions allow conservation fish hatcheries for Delta smelt and Chinook salmon to enhance populations, programs to remove predator fish that prey on endangered species in the Stanislaus River and a similar pilot program in the Delta.

Regulations

The U.S. Environmental Protection Agency (EPA) and the U.S. Army Corps of Engineers have proposed rules under the Clean Water Act that will have a huge impact on ordinary business activities by dramatically expanding federal authority over water and land uses across the country. By redefining what constitutes "waters of the United States" governed by the federal Clean Water Act, the proposed rule could expand federal jurisdiction over waters from 3.5 million river and stream miles to well over 8 million river and stream miles.

The proposal also would likely result in more stringent stormwater management requirements, which would affect retailers, companies with large parking lots, "big box" stores, etc. The two agencies are overreaching in an attempt to replace longstanding state and local control of land uses near water with centralized federal control.

Some impacts include making most ditches into "tributaries," resulting in routine maintenance activities, and on-site ponds and impoundments subject to permits costing around \$100,000 or more, affecting agriculture and local/state agencies; new permitting requirements likely would trigger additional environmental reviews adding years to the completion for ordinary projects; and there is a real possibility that in order to get permits, project proponents will have to agree to mitigate environmental "damage" with costly restoration/mitigation projects. Ditches can be dug on farms for irrigation purposes, along highways and roads for runoff, stormwater purposes, in housing developments to avoid flooding or ponding, etc.

The CalChamber joined with 375 trade associations and chambers in voicing strong objections to the proposal, requesting that the agencies withdraw it and start over. Despite opposition, the agencies went forward to finalize the rule. Several states and private parties filed lawsuits in federal district courts challenging the rule. In October 2015, the U.S. Court of Appeals for the Sixth Circuit stayed the rule while it sorted out whether the courts of appeal or district courts have jurisdiction to handle challenges filed by various states and private parties. Ultimately, the Sixth Circuit decided jurisdiction lies with it and oral arguments are expected in spring 2017. Industry groups, states and environmentalists argued that challenges to the U.S. EPA and Army Corps waters of the United States rule should be decided at the district court level, while the government agencies held the opposing view.

What to Expect in 2017

More fine tuning to the Sustainable Groundwater Management Act is anticipated. Below is a short list of some of the outstanding issues:

- Define groundwater recharge beneficial uses.

- Sideboards for groundwater and surface water connectivity.
- Increase the minimums up from 2 acre-feet.
- Allow for a three- to four-year timeframe for setting up governance.
- Set up a regulatory framework for unique basins.
- Clarify basins or sub-basins or areas defaulting to Water Board jurisdiction.
- Clarify what “equity” is with tribes.

The list is daunting and will take time to work. There is real concern that if the local agencies can't work through logistical problems with designing plans or if the plans are too burdensome, there will be a rush to adjudicate, which will take years, even with the recent changes to the adjudication process.

The CalChamber is part of a coalition formed to support the BDCP/California WaterFix. Californians for Water Reliability includes business leaders, family farmers, labor, community leaders, elected officials, water experts and others focused on generating support to improve the security of California's water supplies through supporting the WaterFix. The business and agriculture communities should be prepared to comment at every opportunity in favor of the plan.

Now is not the time to be diverted away from the main goal of developing additional storage. Project applicants should review the regulations and following the guidance documents provided by the Water Commission to ensure that all application requirements are met. It is important to get applications in early because the amount of funding available will be quickly exhausted.

The State Water Resources Control Board's proposed plans for the San Joaquin River and the Sacramento River need to be closely watched. Regulators should be contacted and apprised of the severe consequences to agriculture and business if the plans are adopted. Comments should be submitted at every opportunity.

The issue of how to address the Governor's desire to fund low-income lifeline rates, and how to charge for stormwater infrastructure will probably lead to a discussion of a public goods charge in the coming years. Environmental justice advocates will continue to pressure the business community to help fund low-income water infrastructure needs.

On federal issues, business and agriculture should watch federal EPA closely as it continues to administer the current regulations on waters of the United States while waiting for

the U.S. Court of Appeals for the Sixth District to decide the consolidated cases before it and ultimately if the new rules will be applied.

How much California water laws and regulations will be affected by the change in administration in Washington, D.C. remains a question. It is important that the business community watch what is happening and stay engaged with federal issues more now than ever before.

CalChamber Position

The CalChamber supports a comprehensive solution to California's chronic water shortage. It is vitally important that all Californians have an adequate and reliable source of water while safeguarding the environment. Developing additional water supplies and conveyance facilities can no longer be postponed without subjecting the state to long-term economic damage. One serious earthquake or a series of Delta levee failures could leave millions of people and businesses without a water supply for the foreseeable future. Every means of providing more water should be vigorously pursued. Preparedness through diversification is the path to a comprehensive solution to California's water future.



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