



THE DEPUTY SECRETARY OF THE INTERIOR
WASHINGTON

APR 21 2016

The Honorable David Valadao
House of Representatives
Washington, DC 20515

Dear Representative Valadao:

Thank you for your letter dated November 24, 2015, regarding the Drainage Settlement between Westlands Water District (Westlands) and the United States (Settlement). In your letter, you requested confirmation of our mutual understanding of the Settlement in a number of areas. Your interest in the Settlement is appreciated and our responses to the specific areas you raised are below.

Litigation and Legal Claims That Would Be Resolved Under the Settlement

Litigation over the United States' obligation to provide drainage service to the San Luis Unit of the Bureau of Reclamation's (Reclamation) Central Valley Project (CVP) has a long and complicated history spanning the last two and a half decades. The summary in your November 24, 2015, letter accurately describes the litigation that the Settlement resolves. Litigation commenced shortly after the United States halted use of the San Luis interceptor drain and plugged all Federal facilities, following the discovery of embryonic deformities of aquatic birds at Kesterson Reservoir. This Settlement resolves *Westlands Water District v. United States*, the remaining breach of contract case relating to the United States' drainage obligation, as well as provides for the vacatur of the 2000 Order Modifying Partial Judgment in *Firebaugh Canal Water District v. United States*, whereby the district court expressly retained jurisdiction and actively exercises a monitoring function over Reclamation's implementation of drainage service in the San Luis Unit. The Settlement also provides a framework for resolving *Michael Etchegoinberry, et. al. v. United States*, which is a Fifth Amendment takings case brought by individual landowners within Westlands. These cases are described in more detail below.

Firebaugh was filed in 1988 by two water districts located outside and "downslope" of the San Luis Unit. The action was partially consolidated with *Sumner Peck Ranch, Inc. v. United States*, a similar action brought in 1991 by approximately 100 landowners located within the San Luis Unit. In 1995, following a trial, the district court entered a partial judgment that the Secretary of the Interior's (Secretary) obligation under the San Luis Act to provide drainage was not excused or rendered impossible. In 2000, the Ninth Circuit largely affirmed the partial judgment, and on remand the district court entered an injunction (2000 Order Modifying Partial Judgment) against the Secretary requiring Reclamation to "promptly" provide drainage service to the San Luis Unit. In 2002, the United States settled the *Sumner Peck* plaintiffs' claims.

In compliance with the 2000 Order Modifying Partial Judgment, the Department developed a Plan of Action outlining the steps it would follow to implement a drainage solution for the San Luis Unit. Following completion of an environmental impact statement, Reclamation issued a Record of

Decision (ROD) in March 2007 to meet the drainage service requirements of the court's injunction. The Department also prepared and submitted to Congress a feasibility report, concluding that the cost of implementing the selected alternative would be approximately \$2.7 billion (now \$3.8 billion in April 2015 dollars). That amount far exceeds the remaining appropriations ceiling authorized for construction of the San Luis Unit. As a result, the alternative selected in the ROD cannot be fully implemented under existing law. As part of the on-going litigation, the Department advised the court in November 2009 that, while it could not implement the entire ROD, sufficient appropriation ceiling remained to allow it to construct one subunit of drainage facilities within Westlands. Beyond that subunit, however, the Department remains unable to continue implementation of the ROD without additional Congressional authorization.

During the same time Reclamation was formulating its plan of action for the implementation of drainage service, the *Firebaugh* plaintiffs continued to seek their own injunction requiring Reclamation to provide drainage service to lands adjacent to the San Luis Unit. On September 30, 2011, the district court held that the San Luis Act imposed no duty on the Secretary to provide drainage service that would protect or remediate conditions on plaintiffs' lands, and the plaintiffs' had failed to demonstrate unreasonable delay by Reclamation in implementing a drainage plan within the San Luis Unit. The district court subsequently entered final judgment on all of the *Firebaugh* plaintiffs' claims and the *Firebaugh* plaintiffs appealed to the Ninth Circuit. On April 3, 2013, the Ninth Circuit affirmed the district court, *Firebaugh Canal Water Dist. v. United States*, 712 F.3d 1296 (9th Cir. 2013); a petition for rehearing *en banc* was subsequently denied and the United States Supreme Court denied cert.

Under the 2000 Order Modifying Partial Judgment, the district court continues to monitor Reclamation's activities to provide drainage service for a subunit of the San Luis Unit within Westlands pursuant to a "Control Schedule." The United States submits biannual reports to the district court, which report on progress in implementing the Control Schedule. The filing of these status reports, supported by a declaration from Reclamation's Mid-Pacific Regional Director presently continues. On October 26, 2015, Judge O'Neill granted a Joint Motion for a Partial Stay by Westlands and the United States and partially stayed implementation of the current Control Schedule through January 15, 2017 while parties continue to work on obtaining legislation required to implement the Settlement, however, the Court did not relieve parties of filing bi-annual status reports with the court.

On September 2, 2011, a group of individual landowners within Westlands filed suit in the Court of Federal Claims alleging that the failure by the United States to provide drainage service to their lands resulted in a physical taking of their property without just compensation in violation of the Fifth Amendment. Plaintiffs brought their suit as a class action on behalf of all landowners located within Westlands "whose farmlands have not received the necessary drainage service the United States is required to provide under the San Luis Act...." A plaintiff class has yet to be certified. A motion by the United States seeking dismissal of the takings claim was denied on September 20, 2013. *Etchegoinberry, et. al. v. United States*, 114 Fed. Cl. 437 (2013). The Opinion contains language sharply critical of the United States' delay in providing drainage to Westlands. Westlands itself is not a party to this litigation, but pursuant to the Settlement would intervene for purposes of settling the case. The Court of Federal Claims has stayed this litigation to allow settlement

negotiations to proceed, but is requiring the submission of regular status reports on the progress of the discussions.

On January 6, 2012, Westlands filed its own suit against the United States also in the Court of Federal Claims, alleging that the government's failure to provide drainage service to the Westlands' service area constituted a breach of Westlands' 1963 Water Service and 1965 Repayment contracts (including the interim renewal of those contracts). The United States moved to dismiss Westlands' claims. On January 15, 2013, the Court of Federal Claims granted the United States' motion to dismiss, ruling that none of the contracts contained an enforceable promise to provide drainage to Westlands. *Westlands Water Dist. v. United States*, 109 Fed. Cl. 177 (2013). Westlands has appealed to the Federal Circuit, and briefing on the appeal is complete. On December 2, 2015, the Federal Circuit granted a stay through January 20, 2017.

Benefits to the U.S. of the Westlands Settlement:

- The Settlement, if authorized by Congress, would relieve the Department of all drainage obligations imposed by the San Luis Act, including implementation of the 2007 ROD, within Westlands. The 2015 costs of implementing the entire ROD are roughly \$3.8 billion.
- Westlands agrees to seek dismissal of the *Westlands* breach of contract litigation and would join the United States in petitioning for vacatur of the 2000 Order Modifying Partial Judgment in the *Firebaugh* case directing implementation of drainage service and control schedules.
- The Settlement establishes a framework for resolving all individual landowner claims in the *Etchegoinberry* takings case. Specifically, Westlands would intervene in this case for settlement purposes and would provide compensation to its landowners. Potential exposure to Federal taxpayers from an adverse judgment could be as high as \$2 billion.
- Westlands agrees to provide for the release, waiver, and abandonment of all past, present, and future claims, including from individual landowners, and further agrees to indemnify the United States for any and all claims relating to the provision of drainage service or lack thereof within its' service area.
- Westlands has also agreed to permanently retire a total of not less than 100,000 acres of lands within its boundaries utilizing those lands only for the following purposes:
 - a. Management of drain water, including irrigation of reuse areas;
 - b. Renewable energy projects;
 - c. Upland habitat restoration projects; or
 - d. Other uses subject to the consent of the United States.
- The Settlement transfers the legal obligation to manage drainage to lands within the Westlands service area from the United States to Westlands.

- Westlands agrees to cap its CVP water deliveries at 75 percent of its contract quantity. Any water savings above this 75 percent cap would become available to the United States for other CVP authorized purposes.
- As part of the overall Settlement, the United States anticipates it will enter into a water service contract with Lemoore Naval Air Station to provide a guaranteed quantity of CVP water to meet the irrigation needs of the Naval Air Station associated with air operations, and Westlands would agree to wheel all CVP water made available to Lemoore.

The Settlement provides the following benefits to Westlands:

- Westlands will be relieved of current, unpaid capitalized construction costs for the CVP, the net present value of which is currently estimated to be \$295 million. Westlands will still be responsible for operation and maintenance, will pay restoration fund charges pursuant to the Central Valley Project Improvement Act and will be responsible for future CVP construction charges associated with new construction for the project.
- The Secretary will convert Westlands' current 9(e) water service contract to a 9(d) repayment contract consistent with existing key terms and conditions. As a "paid out" project, the benefit of this conversion gives the district a contract with no expiration term, consistent with other paid out Reclamation projects. However, the contract will contain terms and conditions that are nearly identical to those in the current 9(e) contract.
- Westlands will be relieved of Reclamation Reform Act (96 Stat. 1269) provisions relating to acreage limitations and full cost pricing. The Reclamation Reform Act grants this relief on its face to projects that are considered "paid-out." Additionally, the tiered pricing provisions are triggered when a district receives 80 percent of its contract quantity, and as part of the Settlement, Westlands water deliveries will be capped at 75 percent of its contract quantity.
- Westlands will also take title to certain facilities including the portion of the San Luis Drain that lies within Westlands' service area.

The Settlement envisions relief from statutory obligations, debt relief, title transfer, and authority to enter into a new CVP water service contract with Lemoore Naval Air Station, all activities requiring Congressional authorization.

Net Benefit for the San Luis Unit Drainage Resolution Act:

There were several aspects regarding the obligation to provide drainage service that were evaluated in determining the overall net benefit to the United States. Included in this consideration were avoided drainage construction costs, repayment to the United States of reimbursable costs, relief from Reclamation Reform Act fees, and unpaid CVP capital obligations. Specific to Westlands, further consideration was given to the indemnification of current legal claims, namely the *Etchegoinberry v. United States* litigation, of which just financial compensation estimates could be as high as \$2 billion.

The result of the Department's net benefit analysis was a savings to the United States of at least \$968.9 million in regards to Westlands. This amount does not include the avoided financial liability in the *Etchegoinberry* claim. The different aspects of the net benefit analysis are summarized below.

- **Avoided Construction Costs to the United States** – Based on current conditions and recognition of completed drainage projects valued at roughly \$700 million in 2015 dollars, particularly in the Northerly Area of the San Luis Unit, the total remaining cost of providing drainage service has been calculated to \$3.1 billion. Approximately \$2.5 billion is associated with the cost to provide drainage service specifically to Westlands while the remaining \$558 million is the total cost that would be needed to address drainage concerns of the Northerly Area of the San Luis Unit.
- **Repayment of Reimbursable Drainage Construction Costs** – Following the completion of drainage construction projects and implementation of drainage service, Westlands would be responsible for reimbursable costs incurred by the United States. Assuming repayment would occur over a 40 year period with zero interest as required by current applicable law, the calculated repayment value in 2015 dollars is approximately \$1.2 billion for Westlands.
- **CVP Capital Obligation Relief** – Your November 24, 2015 letter accurately describes the amount of debt that would be repaid to the United States by the year 2030 associated with continued repayment of Westlands' CVP obligations as \$375 million. For purposes of evaluating a potential settlement, however, we believe the value of repayment in today's dollars is a more accurate representation of the costs of settlement. Consequently, we believe \$295 million, which represents the costs of repayment forgiveness in today's dollars, is the figure that should be used when evaluating the settlement.
- **San Luis Drain Feature Re-Evaluation (SLDFRE)** – Reclamation has undertaken some drainage actions as part of the SLDFRE. The net present value of the debt relief of these construction costs to Westlands is \$13.6 million.
- **Grasslands Bypass Project** – The estimated operations and maintenance obligations that would be forgiven for the Grasslands Bypass Project for Westlands is \$2.6 million. Historically, these costs were previously designated as capitalized construction costs and were not recovered on an annual basis when the expenditures occurred.
- **Reclamation Reform Act Relief** – As part of the Settlement, Westlands would receive relief from the Reclamation Reform Act costs associated with water delivered to full cost lands. The estimated amount of this relief is approximately \$20 million.

The costs to implement drainage actions in Westlands in this analysis are based on the costs in the 2007 ROD, indexed to April 2015 dollars. We recognize that Westlands can realize efficiencies, such as using local or in-house labor, reduced travel, and different purchasing requirements than Reclamation, that reduce their cost to implement drainage as compared to the costs if Reclamation were to implement the 2007 ROD. In addition, it is widely recognized that the drainage issue may have lessened over the last few years due to drought and irrigation efficiencies, but we are of the view

that long term, there will be a need for substantial financial investment to alleviate drainage concerns in the San Joaquin Valley. While California has experienced a series of dry years recently, the historic hydrologic record indicates that wet cycles will return and drainage will again become a substantial challenge in the San Luis Unit.

In addition, with Westlands responsible for drainage within its boundaries, there is more incentive to increase irrigation efficiencies as new technology is developed in the future, which is a component of managing drainage that is largely outside of Reclamation's control. It should also be noted that Westlands will be responsible for implementing drainage in perpetuity. The costs in this analysis have only been indexed to April 2015 dollars. These costs will rise as drainage actions are implemented many years and potentially, decades into the future.

Based on these and other terms of the Settlement, it is our belief that the Settlement results in significant savings to American taxpayers when compared to the unavoidable costs that would occur without the terms agreed to in the Settlement. Moreover, we are also of the view that failure to settle on-going litigation will place the Department's ability to address the effects of the ongoing drought in both the short and long term at risk due to the potential of significant amounts of appropriations being expended on providing drainage service. As a practical matter, should our efforts to settle litigation with Westlands fail, funding for programs throughout the Mid-Pacific Region are likely to be reduced in order for Reclamation to adequately fund the Control Schedule. Please find the attached "Costs and Benefits to the Federal Government" table for Westlands that succinctly capture the information presented in this letter.

We want to again express our appreciation for your attention to this matter. Please contact us if you have any further questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael L. Connor", written in a cursive style.

Michael L. Connor

Enclosures

**U.S. Bureau of Reclamation's Assessment of
Costs and Benefits to Federal Government of Westlands' Drainage Settlement
(Presented in Present (2015) Net Worth)**

Benefits to Federal Government	Costs to Federal Government
<p>\$1.3 billion saved¹ <i>\$2.5 billion (estimated cost of drainage for Westlands) minus \$1.2 billion (present value of Westlands construction repayment)</i></p>	<p>\$295 million in 2015 dollars³ <i>(Westlands repayment of CVP capitalized construction obligations of \$375 million, discounted to value in 2015)</i></p>
<p>\$0 to \$2 billion saved² <i>(Takings claims)</i></p>	<p>\$13.6 million San Luis Drain Feature Re-Evaluation (SLDFRE)⁴ <i>(Westlands repayment of SLDFRE capitalized construction costs of \$23.6 million, discounted to value in 2015)</i></p>
	<p>\$2.6 million Grasslands Bypass⁵ <i>(Westlands O&M obligation for Grasslands Bypass)</i></p>
	<p>Total of \$19.9 million over next 15 years⁶ <i>(Reclamation Reform Act Relief)</i></p>
<p>Total Savings: \$1.3 to \$3.3 billion</p>	<p>Total Costs: \$331.1 million</p>

¹ Total drainage construction costs (as provided for under the 2007 Record of Decision) indexed to April 2015 are \$3,798,393,390. Northerly Area portion of drainage costs were removed leaving \$2,535,021,682 related to Westlands Water District. Assuming annual spending is straight-lined over a 15 year period, the annual straight-lined expense to implement drainage is compounded to the year 2030 at an inflation rate of 3%, resulting in the annual escalation of costs. An additional \$1,236,868,997 is subtracted to account for the assumed 40 year construction repayment with no interest beginning in 2030 discounted to 2015 dollars at a 3% discount rate.

² Estimated range of damages and pay compensation for takings claims arising out of Etchegoinberry v. U.S. litigation.

³ Present value calculation (using 3% discount rate) for Westlands remaining CVP capitalized construction obligation. Assumed Westlands would continue to repay \$375 million until year 2030 with no interest.

⁴ Present value calculation (using a 3% discount rate) for Westlands repayment obligation for capitalized construction costs associated with San Luis Drain Feature Re-Evaluation, with repayment beginning in 2016. Assumed Westlands would repay \$23.6 million over 40 years.

⁵ Estimated O&M obligation for Westlands (Broadview assignment only) for drainage costs associated with Grasslands Bypass. These costs were previously designated as capitalized construction costs and were not recovered on an annual basis when the expenditures occurred.

⁶ Estimated Reclamation Reform Act (RRA) revenue Reclamation could have received by 2030. Amount varies year to year and is dependent on annual allocation and application of water placed on to full cost lands pursuant to the RRA.

April 20, 2016