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FEATURE ARTICLE

CALIFORNIA WATER COMMODITIZED?— A NEW PRICING INDEX EMERGES ON THE NASDAQ

By Derek Hoffman and Michael Duane Davis

On the first day of one esteemed university economics course, a professor circulates physical objects around the classroom for students to heft and examine—things like corn, wheat, soybeans, gold, silver, copper, spices and wood. These items, the lesson goes, are valuable natural resources. They also comprised the means of trade in the earliest of civilizations—gold for wheat; spices for wood—that is, until the concept of *money* took hold as the primary currency of trade. "Currency" is commonly defined as the fact or quality of being generally accepted or in use. So long as money is "generally accepted" and "in use" in the marketplace, those with gold can simply *buy* wheat. Those with spices can simply *buy* wood. No longer must one commodity be directly exchanged for another.

In today's sophisticated and global marketplace, thousands if not millions of commodities transactions occur daily. Data-driven financial indexes inform buyers and sellers regarding commodity prices. Tradable financial instruments enable transactions not only to meet today's commodity demands but also future demands, and can hedge against anticipated fluctuations in price and availability.

But what about water? More specifically, what about California water? Is it—or should it be—considered a commodity? How does such a characterization reflect and respect established water rights, laws and regulations? How are—or should—water rights transactions be priced, and based on what types and quality of information?

A New Index on the NASDAQ®

Indexes have long existed to track value and provide investors with access to *companies and utilities* that develop, produce, treat and supply water resources (*e.g.*: S&P Global Water Index, ticker symbol: SPGTAQD). Likewise, indexes for commodities like those mentioned above are ubiquitous.

On October 31, 2018, a new index emerged. The NASDAQ Veles California Water Index (ticker symbol: NQH20) (NQH20 or Index) tracks what it describes as the "spot price" of *water* in California based on certain types of groundwater and surface water transactions in specific California water markets. Veles Water Limited's (Veles) Chief Executive Officer expects the Index:

> . . .to facilitate tradeable cash-settled futures contracts within [a year] to allow farmers, utilities and industrial water users to hedge the financial risk of volatile water availability [and] provide investors with a means to speculate on the future price of water without taking on the underlying risk of owning assets. (*See*, https://www.globalwaterintel.com/news/2019/2/california-water-pricing-index-launches-on-nasdaq, last visited February 21, 2019.)

NQH20 was developed and is maintained by NASDAQ, Veles and WestWater Research LLC (WestWater). NASDAQ created the world's first electronic stock market and today provides global trading, clearing, exchange technology, listing, information, and public company services, including supporting more than 100 marketplaces in 50 countries and over 4,000 total listings with a market value of approximately $15 trillion. (*See*, https://business.nasdaq.com, last visited February 21, 2019.) Veles is a financial products company based in the United Kingdom specializing in water pricing, water financial products, and water economic and financial methodologies. (*See*, www.

veleswater.com, last visited February 21, 2019.) Data for the Index is provided exclusively by WestWater, an economic and financial consulting firm specializing in water rights and water resource acquisition and development throughout the United States.

Index Calculations, Adjustments, Pricing

While many aspects of the Index are deemed proprietary, NASDAQ provides some information about the functionality of the Index in its "NQH20 Methodology Report" (Index Report) (*See*, https://indexes.nasdaqomx.com/docs/methodology_NQH2O.pdf, last visited February 21, 2019.) The Index Report states that listed figures reflect the "commodity value of water" at the source, and do not include additional costs associated with transportation or losses such as through evaporation. Index data is also limited to transactions resulting from arms-length negotiations, and excludes transactions that do not include financial consideration.

The Index is priced in terms of U.S. Dollars per acre-foot and uses a "modified volumeweighted average" of prevailing prices in selected underlying water markets after adjusting for "idiosyncratic pricing factors" specific to those water markets and specific types of eligible transactions. The Index is calculated and published following the close of business each Wednesday based on data obtained through the end of the prior week.

On opening day, the Index listed a California water "spot price" of $511.33 per acre-foot based upon 293 water transactions between approximately January and August 2018. Since then, the listed spot price has ranged between a low of $ 447.64 per acre-foot and a high of $576.30 per acre-foot. (*See*, https://indexes.nasdaqomx.com/Index/History/NQH2O, last visited February 21, 2019.)

Index Data: Eligible Water Markets and Transactions

Only certain groundwater and surface water markets and transactions are deemed eligible data sources for the Index. As described in the Index Report, current Index-eligible data sources are limited to five large and actively traded markets in California, including four groundwater markets and a generally-described surface water market.

Central Basin—Groundwater

The Central Basin underlies an approximately 227-square-mile area in Los Angeles County. The original judgment in Central Basin adjudication was entered in 1965 (*Central and West Basin Water Replenishment District v. Charles E. Adams et al.*, Los Angeles County Superior Court Case No. 786656) and has since been amended several times including most recently in 2013. The Central Basin adjudication establishes limits on total annual groundwater production and establishes allowed pumping allocations (APA) among the parties. The total APA exceeds the natural yield of the basin and relies upon recharge from imported and reclaimed water. The adjudication authorizes parties to purchase or lease APA through an established "Exchange Pool." Unused APA may be carried over into the following administrative year subject to certain timing and volumetric limitations; and, carryover water may also be traded. Eligible transactions for inclusion in the Index include permanent transfers of APA, single- and multi-year leases of APA and leases of carryover water.

Chino Basin—Groundwater

The Chino Basin underlies an approximately 235-square-mile area of the Upper Santa Ana River Watershed within portions of San Bernardino, Riverside, and Los Angeles counties. The original judgment in the Chino Basin adjudication was entered in 1978 (*Chino Basin Municipal Water District v. City of Chino et al.*, San Bernardino Superior Court Case No. RCV 164327 (now Case No. RCV 51010)), and has since been amended several times including most recently in 2012. The Chino Basin adjudication established a basin safe yield and allocated water rights among three distinct producer "Pools", including an Overlying Agricultural Producers Pool, an Overlying Non-Agricultural Producers Pool and an Appropriative Producers Pool.

Transfers and leases of water rights are subject to specific limitations. Transfers are generally not permitted within the Agricultural Pool; though, unused water is made available annually to the Appropriative Pool. Overlying Non-Agricultural Pool producers may both permanently transfer and temporarily lease water within their Pool and may lease water annually to Appropriative Pool producers pursuant to specific regulatory requirements. Appropriative Pool produc-

ers which primarily comprise municipal water providers, may both permanently transfer and temporarily lease water within their Pool. Both Overlying Non-Agricultural Pool and Appropriative Pool producers may carry over unexercised rights subject to certain limitations. Supplemental water may be stored, and both carryover and storage water may be transferred following the same rules applicable to the use of groundwater rights for each Pool.

Eligible transactions for the Index include temporary (single- and multi-year) transfers within the Appropriative Pool and within the Overlying Non-Agricultural Pool, and annual leases from the Overlying Non-Agricultural Pool to the Appropriative Pool pursuant to the regulatory framework. Eligible temporary transfers include those with single or multi-year terms. Temporary transfers of carryover and storage water are also considered eligible. The Index also includes permanent transfers of rights among Appropriative Pool and Overlying Non-Agricultural Pool producers.

Main San Gabriel Basin—Groundwater

The Main San Gabriel Basin underlies an approximately 167-square mile area in the southeasterly portion of Los Angeles County. The original judgment in the Main San Gabriel adjudication was entered in 1973 (*Upper San Gabriel Valley Municipal Water District v. City of Alhambra, et al.*, Los Angeles County Superior Court Case No. 924128), and has since been amended several times including most recently in 2012. Among many of its major components, the judgment established a Watermaster responsible to determine an annual basin Operating Safe Yield (OSY). The judgment allocated prescriptive water rights (and other types of rights in certain circumstances) among producers, which also provides the basis for each party's share of the OSY. Unused OSY may be carried over one fiscal year. Eligible transactions for the Index include both temporary (single- and multi-year) transfers of production rights and carry over, as well as permanent transfers of water rights.

Mojave Basin Alto Subarea—Groundwater

The Mojave Basin Area underlies an expansive approximately 3,400-square-mile area the high desert region of San Bernardino County. The original judgment in the Mojave Basin Area adjudication was entered in 1996 (*City of Barstow, et al. v. City of Adelanto, et al.*, Riverside County Superior Court Case No. CIV 208568) comprising a stipulation among over seventy-five percent (75 percent) of the parties and representing over eighty percent (80 percent) of the verified water production within the basin. The judgment was partially amended in 2002 following a decision of the California Supreme Court (*City of Barstow v. Mojave Water Agency*, 23 Cal.4th 1224 (2000)) arising from appeals pursued by certain non-stipulating parties.

The judgment recognized five distinct but hydrologically interconnected Subareas including the Alto (including a portion referred to as the "Transition Zone"), Centro, Este, Oeste and Baja Subareas. The judgment required each Subarea to ensure a certain amount of Mojave River flow to adjacent downstream Subareas. The Judgment established Base Annual Production Rights (BAP) within each Subarea, and imposed Rampdown obligations to achieve basin sustainability. Each year, the court reviews and determines the volume of water to be allocated to water producers in the form of a Free Production Allowance (FPA), which is a portion of BAP that may be produced during without incurring a Replacement Obligation necessary to fund imported supplemental water. Unproduced FPA may be carried over for one administrative year. The judgment authorizes both temporary and permanent transfers of BAP and FPA.

Eligible transactions for the Index are limited to those within the Alto Subarea, which is the largest and most active Subarea market. The Index includes temporary (single- and multi-year) transfers, including carryover, and permanent transfers of Alto Subarea BAP.

Surface Water

As noted in the Index Report, the majority of California's surface water resources originate north of the Sacramento-San Joaquin River Delta (Delta), while the majority of demand for that water is located south of the Delta. The extensive California State Water Project (SWP) and federal Central Valley Project (CVP) storage and conveyance facilities enable a surface water market through which (complex) water transfers are established among parties throughout California. The Index Report describes eligible surface water transactions for the Index to include temporary (single- and multi-year) and permanent

transfers of SWP entitlements, CVP entitlements, and "other surface water entitlements.

A First Step—To Where?

According to Veles' CEO:

> . . .[w]ater is our most important commodity and until now, there were no financial risk management instruments available in the global financial markets. We see the [Index] as an important first step to understanding water as a commodity, which means a more transparent and accessible marketplace for all.

Similarly, NASDAQ's Vice President and Head of Research and Product Development for NASDAQ's Global Indexes, Dave Gedeon, stated that:

> . . .[t]he NASDAQ Veles California Water Index can bring dramatic change to the way we quantify and value an important resource. (*See*, https://www.nasdaq.com/press-release/nasdaq-launches-water-pricing-index-20190108-00379, last visited February 21, 2019.)

Notably, these comments declare the Index to be a first step toward dramatic change in the way water is valued. This begs the question, "a first step to where?" One notable financial industry leader has painted a picture of what he believes this "dramatic change" will be. In a lengthy report principally authored by Willem Buiter, Global Chief Economist for Citi Investment Research & Analysis (a division of Citigroup Global Markets Inc.) (Citi) Citi predicted in 2011:

> I expect to see in the near future a massive expansion of investment in the water sector, including the production of fresh, clean water from other sources (desalination, purification), storage, shipping and transportation of water. I expect to see pipeline networks that will exceed the capacity of those for oil and gas today. I see fleets of water tankers (single-hulled!) and storage facilities that will dwarf those we currently have for oil, natural gas and LNG … I expect to see a globally integrated market for fresh water within 25 to 30 years. *Once the spot markets for water are integrated, futures markets and other derivative water-based financial instruments—puts, calls, swaps—both exchange-traded and OTC will follow. There will be different grades and types of fresh water, just the way we have light sweet and heavy sour crude oil today. Water as an asset class will, in my view, become eventually the single most important physical-commodity based asset class, dwarfing oil, copper, agricultural commodities and precious metals.* (Citi, Global Themes Strategy: Thirsty Cities—Urbanization to Drive Water Demand, July 20, 2011, http://www.capital-synthesis.com/wp-content/uploads/2011/08/Water-Thirsty-Cities.pdf, last visited February 21, 2019.)

Water Rights and SGMA

The changes predicted by Citi are, indeed, dramatic. While price indexing may serve to inform market participants and transactions, water markets themselves are governed by established and (generally) orderly water rights laws and principles —at least in California and the United States.

In California, one potentially fertile testing ground for the Index's informational value may be through the implementation of the Sustainable Groundwater Management Act of 2014 (SGMA). As of today, the California Department of Water Resources has identified 517 distinct groundwater basins and sub-basins, approximately a quarter of which are required to develop and implement first-ever Groundwater Sustainability Plans (GSPs) to achieve long-term basin sustainability.

Among its many features, SGMA authorizes newlyformed Groundwater Sustainability Agencies (GSAs) to establish groundwater pumping allocations and transferability as a management tool to achieve basin sustainability. (California Water Code, § 10726.4). GSP allocation schemes are, however, subject to limitations including, for example, generally complying with established land use plans and occurring only within the GSA's jurisdictional boundaries. (*Id.*) Of course, neither a GSP nor a GSA has authority to determine or alter water rights, which also delimits the parameters of an allocation framework. (*Id.* at § 10720.5.)

In this context, the question to be tested in the coming years would be whether and to what extent the Index (or something like it) might meaningfully inform a specific buyer and/or seller regarding an appropriate price in transacting a pumping alloca-

tion transfer in a specific groundwater basin pursuant to a specific allocations framework that is subject to specific GSP provisions and other State laws and municipal ordinances. Extending the hypothetical, the question becomes more acute with respect to inter-basin transfers (subject to the same, if not more, legal limitations). In other words, the ultimate informational value of the Index will likely be shaped by the extent to which the underlying assumptions and data that are used for the Index are considered to be similar to and reflective of the local conditions of a particular basin and transaction.

As GSAs implement allocation frameworks through their GSPs resulting in new local markets, more transactional data will presumably become available for inclusion in the Index, which may reduce perceived data asymmetry and build confidence in the Index. Regardless, buyers and sellers will need sufficient information about the Index itself, including how it functions and the data upon which it is based, in order to evaluate its appropriateness in valuing a particular transaction.

Conclusion and Implications

Clearly, the value of water as a natural resource necessary to life and economy in California will only continue to rise. The whiplash of the recent historic drought followed by dramatic wet years has triggered major changes in California water law and policy, including providing for the development of new water markets and more expansive and robust databases and information.

Transferability of water resources will continue to serve an important management tool. The price attributed to a particular transfer is expected to be governed by *market conditions*, the applicable *laws and ordinances* and the nature and value of the underlying water *rights* upon which the transaction is based. The informational value of the Index to any particular transaction remains to be seen and will depend on these and many other factors. A buyer and seller would need to evaluate whether and to what extent the "spot price" of the Index reflects the unique local conditions and aspects of the transaction. That informational value may grow over time as new and broader market data is incorporated.

So long as that buyer and seller are transacting in a system still governed by water rights laws, they are probably not confronted with the naval-gazing question of whether water is simply a commodity.

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CALIFORNIA WATER NEWS

PROPOSED UTAH-COLORADO WATER TRANSFER PIPELINE PROJECT REVIVED UNDER NEW TERMS

A Colorado entrepreneur, through a newly created LLC, has filed for water rights in Utah's Green River in the latest iteration of a decade-old plan to bring additional water to Colorado's Front Range. That application, like its predecessors, faces steep opposition from a variety of environmental, private, and governmental groups.

Background

Aaron Million originally conceived of this plan 15 years ago while working on his master's thesis at Colorado State University. Since then, Million's plans have been defeated and then re-hatched multiple times, giving the project the nickname "zombie pipeline." An early version called for pumping 250,000 acre-feet to Colorado and was quickly dismissed. In 2010 the project was called the Flaming Gorge Pipeline and proposed to pump more than 200,000 acre-feet water from Flaming Gorge Reservoir in Wyoming to Colorado annually. That 500-mile pipeline was slated to run all the way to Pueblo, Colorado on the southern tip of the Front Range. After being opposed on all fronts, it was finally rejected by the Colorado Water Conservation Board and Federal Energy Regulatory Commission in 2012.

A New Proposal

Undeterred, the project has again surfaced, this time under Million's new entity Water Horse Resources, LLC. Water Horse submitted an application to the State of Utah in January of 2018, this time claiming 76 c.f.s. for a total of 55,000 acre-feet, annually, from the Green River below Flaming Gorge. This revised version of the pipeline project is only about a quarter of the 2010 proposal, which Million hopes will allay the 2012 concerns that there was simply not enough water in the river.

Nevertheless, the application was opposed by almost 30 individuals, environmental groups, river districts in Colorado and Utah, and governmental agencies including the Bureau of Reclamation and the BLM. The State of Colorado has taken a wait-and-see approach, noting that it will remain neutral for the time being.

One of the chief concerns raised by opposers is that the plan is widely speculative, considering that Water Horse has not yet revealed a buyer for the large volumes of water. Million claims that he does in fact have a buyer interested in purchasing the entire 55,000 acre-feet to use on the Front Range. However, the only evidence presented in the application were letters of interest from potential buyers relating to the 2010 proposal. The Central Colorado Water Conservancy District (CCWCD) is the only Colorado entity to have openly expressed interest in the water from the Water Horse pipeline. The CCWCD, which has since joined an advisory board for the Water Horse project, is very interested in the pipeline because water shortages have left the district about 50 percent short on its deliveries in an average year.

This latest proposal plans for an underground pipeline, approximately 40 inches in diameter, that would divert from the Green River—below Flaming Gorge and above Dinosaur National Monument—and then run east across Wyoming before turning south into Colorado along the Front Range. Water Horse has estimated that the project will cost between $860 million and $1.1 billion to construct. Million has mentioned the possibly of using existing oil and gas pipelines to transport the water, but there have been no official plans yet revealed so it is unclear how viable such a plan would be.

Water and Hydroelectricity

In addition to revenue from the sale of water, the pipeline is projected to generate 70 megawatt hours of hydroelectric power per year thanks to a 3,800-foot vertical drop from the Continental Divide to the Front Range. After the pipeline is up and running, Million has discussed a second phase involving pumped-storage facilities to increase hydropower efficiency, generating an additional 500 to 1,000 megawatt hours annually. At a November hearing of the Utah Board of Water Resources, Million noted

that, "[i]t's becoming as much a renewable-energy project as water supply." In that hearing the proposal was roundly criticized by groups and individuals as disparate as Utah ranchers and Colorado environmental groups. The only group to support the project had a clear agenda—Pipeliners Local Union 798. Much of the other criticism brought up at the hearing dealt with the vagueness of the proposal, with the initial plans leaving the public unable to determine the viability of the plan. Those concerns led to the Utah State Engineer's office on December 10, 2018 to request additional information from Million and Water Horse to prove, principally, that water is available and that the project is feasible.

Update: Water Rights and Environmental Concerns

Water Horse answered those questions on February 8, 2019 in a sprawling response that totaled almost 250 pages, including exhibits. Responding to the questions about physically and legally available water, Water Horse noted that the Green River has so few diversions compared to users that "it has never been necessary to regulate Green River water rights by priority." Turning to a legally available water supply, Water Horse claims that: 1) the Law of the River dictates that this water would be charged to Colorado because the 1922 Colorado River Compact focuses on place of use, and 2) the 2010 CWCB Statewide Water Supply Initiative found that Colorado has between 445,000 and 1,438,000 acre-feet per year available under its Compact entitlements. Therefore, the response claims, the Water Horse proposal would use both a physically and legally available water supply.

Pivoting to environmental issues, Water Horse admitted that the most straightforward legal approach would have been to divert from the Green River in Colorado, run the pipeline through Colorado, and therefore file the application in Colorado. However, Water Horse claims that technical and environmental issues make that current proposal the most feasible. Other environmental issues, particularly those concerning fish and other wildlife, have been a contentious point through the various iterations of this project. In the February 8 response, Water Horse seemed to punt on this issue, claiming that there is plenty of water in the Green River at the point of diversion to support fish habitat, but that's also a moot point at this time because federal involvement will necessitate Endangered Species Act and National Environmental Policy Act (NEPA) review in the future.

Conclusion and Implications

All opposers now have 30 days from February 8 in which to offer any comments to Water Horse's response. There is no timetable on an expected resolution of this proposal, but if the past applications are any guide, it will be several years before the application is granted or denied.
(John Sittler, Paul Noto)

RECENT CALIFORNIA WILDFIRES HIGHLIGHT POTENTIAL NEGATIVE IMPACTS ON WATER QUALITY

The 2018 wildfire season marked the deadliest and most destructive in the history of California. The damage to life and property suffered by those impacted continues to be felt as local communities begin to rebuild. Recently, a number of studies have emerged which analyze the impact of wildfires on water quality by examining potential damage caused by trace elements of sedimentation, ash deposits and organic debris reaching water sources.

Background

According to the California Department of Forestry and Fire Protection, the 2018 wildfire season was the most destructive wildfire season on record in California. Recent research cited an increase in the number of wildfires due to an increased amount of natural fuel consisting of dead tree matter. This large amount of dead tree matter is largely determined to be the result of record drought. Experts warn that is likely that California will continue to experience massive wildfires events in the future.

The extent of potential environmental impacts of wildfires remains a rather new area of study, particularly with respect to impacts on water quality. Historically, focus has been primarily on the ability to supply water to combat the flames. Environmental studies related to water quality have been largely limited to the risk of mudslides caused by heavy rain events in burned areas. One of the reasons could be the inherent difficulty in conducting water quality testing in burn areas which requires sampling of water quality just before and just after a wildfire. Preliminary studies, however, uncovered a bevy of potential water quality problems resulting from wildfires.

A Complicated Chain of Events

The first rain event after a wildfire often spurs a sense of fear for communities as they continue the rebuilding process. Without adequate plant anchorage to hold hillsides in place, rain events are prone to cause dramatic stormflow shifting mud and debris. Mudslides often add to property damage suffered in these areas, and is cause for concerns about water quality because mudslides can potentially reach water sources and create suspended sediment concentrations. Suspended sediment can affect the color and turbidity of water. It also has a tendency to carry particulates into water sources which, depending on the area burned, may include harmful contaminants. Suspended sediment can also make it difficult to detect bacteria and viruses located in the water supply and can have drastic effects on the quality of water when entering distribution pipelines.

Recent studies examined the effects of ash and organic debris on water quality. Ash has been found to contain trace elements such as copper, nitrogen, zinc, and iron. The trace element content in ash also varied by the source of the ash. For example, ash generated from burned residences was found to contain higher concentrations of trace elements compared to ash collected from wildland areas. This has found to be linked to treated wood, paint, wiring, pipes and other building materials used in construction. If introduced to the water supply, they may lead to problematic water contamination. It remains uncertain what health impacts this exposure could have, but the presence of trace elements remains an after-fire water quality concern. In addition, organic debris has been found to have entered waterways, resulting in the presence of higher levels of dissolved organic carbon (DOC) in water sources. When combined with the ash trace element, DOC can alter the pH level of the water system, raising significant water quality concern

Damage to infrastructure caused by wildfires also raises water quality concerns. By way of illustration, after the wildfire raged in Paradise, benzene, a known carcinogen, was found in the domestic water supply. As a result, Paradise issued a boil water notice to the community as water testing efforts were taking place. Investigation found that the extreme heat from the fire had melted the plastic (PVC) water pipes as well as other plastic components of the city's water distribution system. The firefighting activities potentially resulted in a drop in water pressure in the system which allowed benzene-contaminated water to flow throughout the system. This raises an unchartered issue for public agencies located in areas with potential high risk of wildfires.

Contaminants entering the water supply system not only impact potable water but also ecosystems de-

pendent on those sources of water supply. The influx of trace elements and DOC may alter the pH of water making such water ecosystems uninhabitable for sensitive plants and animals. The potential storm runoff can also increase the amount of nutrients entering a water system which carries the risk of algae blooms in water sources. This may create hypoxic conditions as a result of algal bloom and potentially cause animals and plants to die off in large numbers in the affected ecosystems.

Conclusion and Implications

It remains to be seen how localities will address these new water quality concerns. Accurate testing remains a difficult goal in order to truly understand the impact of wildfires on water quality. However, as the recent events in Paradise show, these environmental impacts can have a dramatic effect on water quality and potentially human health.
(Geremy Holm, Steve Anderson)

LEGISLATIVE DEVELOPMENTS

IN THE FACE OF TRUMP ADMINISTRATION REPEAL OF VARIOUS HEALTH AND ENVIRONMENTAL REGULATIONS, THE CALIFORNIA LEGISLATURE PUSHES BACK WITH SENATE BILL 1

Described as a necessary stopgap to the Trump administration's repeal of public health and environmental regulations, Senate Bill 1 (2019-20) (SB 1), introduced at the end of 2018, seeks to set 2017 federal standards as a baseline for state regulation. Titled the California Environmental, Public Health, and Workers Defense Act of 2019, SB 1 calls out federal law and regulations implementing the Clean Air Act, Safe Drinking Water Act, Federal Water Pollution Control Act (Clean Water Act), Endangered Species Act, as well as the Fair Labor Standards Act, Occupational Safety and Health Act, and Coal Mine Health and Safety Act. SB 1 directs various administrative agencies to track, list, and assess federal amendments to regulations under these acts, and to consider whether 2017 federal standards should be adopted as state law. The bill also provides for citizen suits to enforce certain standards adopted under the bill.

Background

SB 1 is one more example of the reaction by California state government to the Trump administration. The bill was introduced by Senators Toni Atkins (SD-39), Anthony Portantino (SD-25), and Henry Stern (SD-27) at the end of 2018. The bill has been referred to the committees on Environmental Quality, Natural Resources and Water, and Judiciary, and is scheduled to be heard on March 20. The bill addresses air quality regulation, water quality regulation, and endangered and threatened species in three separate subdivisions. Labor standards are also addressed separately.

Federal Water Quality Standards in Place on January 19, 2017

Specific to the subdivision on water, SB 1 would set those federal standards in effect as of January 19, 2017 under the Safe Drinking Water Act and the Clean Water Act as "baseline federal standards." The bill then directs the State Water Resources Control Board (SWRCB) to regularly assess proposed and final changes to the federal standards; the SWRCB is to publish a quarterly list documenting the changes and noting whether the new standards are more or less stringent than the baseline federal standards.

In the event the SWRCB determines that any new standards are less stringent than the baseline federal standards, the SWRCB may adopt the baseline federal standards as state law "to maintain the state's protections." SB 1 explicitly permits the SWRCB to adopt the regulations as emergency regulations, and hence avoid normal review by the Office of Administrative Law. The SWRCB would be required, however, to publish the list of amendments, assessments, and regulations being considered for adoption at least 30 days prior to a vote on any adoption. Regulations adopted as emergency regulations have a sunset date of January 20, 2021. The bill allows for a citizen suit, with certain prerequisites including a 60-day notice, to enforce any baseline federal standards adopted by the SWRCB. The bill also deems any amendment which restricts or limits the federal citizen suit provision in the Clean Water Act to be an amendment to the baseline.

Air Quality and Endangered Species

SB 1 proposes similar tracking and adoption procedures for federal standards under the Clean Air Act, federal Endangered Species Act (ESA), and federal labor laws, defining baseline federal standards specific to each subdivision. In the subdivision addressing the ESA, the bill defines "baseline federal standards" as those standards under implementing regulations as well as "any incidental take permits, incidental take statements, or biological opinions" in effect as of January 19, 2017. The bill permits the Fish and Game Commission to list by emergency regulation any species delisted under the ESA. The bill also mandates that the California Department of Fish and Wildlife ensure that protections set forth in the baseline federal standards, including regulations, incidental

take permits, or consistency determinations, remain in place. Unlike the subdivisions on air and water regulation, the subdivision addressing the ESA does not include a citizen suit provision.

A Two-Step Approach with Substantial Agency Discretion

SB 1 is a reintroduced version of SB 49(2017-18), authored by Senators Kevin de Leon and Stern, which passed the Senate but died in the Assembly in the last legislative session. While SB 1 maintains the two-step approach to identifying amendments to the federal standards and adopting the baseline, the bill appears to give the state administrative agencies more discretion to determine whether the baseline federal standards should in fact be adopted as state regulation than did SB 49. The citizen suit provision, which raised concern regarding SB 49 by allowing private enforcement of state law, is substantially unchanged in SB 1 with the exception of omitting the availability of civil penalties as a remedy.

If adopted, SB 1 will add potentially significant added duties on state administrative agencies. Because January 19, 2017 is the "baseline" date, it would appear that agencies would need to review over two years of amendments for assessment and potential adoption. This process would be repeated quarterly under the bill. While SB 1 appears to gives agencies more discretion to adopt baseline federal standards as state law than did SB 49, it's possible that the required review and assessment could result in substantial additional rulemaking by agencies.

Conclusion and Implications

While SB 1 would add to the duties of administrative agencies, it does not appear it would expand their authority significantly. With limited exceptions, California administrative agencies are free to adopt stricter environmental regulation than federal standards. SB 1 makes this longstanding trend more explicit.

The additional duties imposed by SB 1 could lead to litigation against state agencies by parties unhappy with how they have met, or failed to meet, those new duties. The review required SB 1 could create opportunities to litigate state agency positions and decisions that would not have arisen absent such review.

The most likely impactful implication of SB 1 would be the new availability, and thus proliferation, of litigation styled as citizen suits to enforce new state regulations. The expanded availability of citizen suits was a noted concern regarding SB 49. SB 1 does omit the availability of civil penalties as a remedy, however, recovery of attorneys' fees by successful plaintiffs would still be, and hence eliminating penalties may not assuage concerns relating to potential citizen suits. Tracking the progress of Senate Bill 1 is available online at: https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200SB1
(Carissa Beacham, Dan O'Hanlon)

PROPOSED CALIFORNIA CONSTITUTIONAL AMENDMENT SEEKS TO ADDRESS WATER QUALITY ISSUES FOR DISADVANTAGED COMMUNITIES

A number of disadvantaged communities in California are experiencing poor water quality issues. California legislators and regulators have been addressing these issues through a series of legislative enactments, though funding remains one of the main obstacles. Currently, there are two proposed legislative bills seeking to address funding.

Background

Inadequate access to clean water remains a reality in a number of disadvantaged communities in California. By way of example, some residents living in Tulare County are currently at the center of a growing drinking water crisis within the San Joaquin Valley. Tulare County is a relatively low-income community that is largely agricultural. Over 90 percent of Tulare County residents rely on groundwater as their main source of drinking water. However, deteriorating quality of groundwater has raised some health concerns, causing area residents to rely on purchased bottled water. Treatment of groundwater is costly, which makes the imposition of higher water rates on residents in disadvantaged communities often difficult to

achieve. California's Legislature continues to address this issue and explore creative options with reduced financial impacts on disadvantaged communities.

Addressing Water Systems in Disadvantaged Communities

In 2016, the California Legislature passed Senate Bill 552 which granted the State Water Resources Control Board (SWRCB) additional authority to manage water systems in disadvantaged communities. Cal. Health and Safety Code, § 116682(a). Under this bill, if the public water system serving a disadvantaged community consistently fails to provide adequate supply of safe drinking water, the SWRCB may order consolidation and take control of the water system directly. Additionally, the SWRCB has the power to order expansion of water systems into disadvantaged areas in order to provide clean water. In situations where consolidation is not feasible, the SWRCB retains the authority to contract with an administrator to provide managerial and administrative services to correct the issues with the failing water system. Cal. Health and Safety Code, § 116686(a)(1). The administrator may expend available moneys for infrastructure improvements and maintenance requirements. Cal. Health and Safety Code, § 116686(d)(1). Additionally, the administrator has the power to set and collect user water rates in order to meet program requirements. Cal. Health and Safety Code, § 11686(d)(2).

Safe and Affordable Drinking Water Fund

In 2017, the SWRCB took measures to address water funding issues in disadvantaged communities. Under the 2017-2018 Drinking Water State Revolving Fund Intended Use Plan (IUP), the SWRCB created a new designation of small community water systems that are eligible for principal loan forgiveness for up to 50 percent of the initial project costs. The IUP does not provide for ongoing maintenance and operation costs; which led to a budget proposal by Governor Newsom aimed at providing such funding.

The proposed budget would create the Safe and Affordable Drinking Water Fund (SADWF), which would be administered by the SWRCB and funded through a water tax based upon the policy framework of Senate Bill 623, a voluntary tax bill which was initially introduced in 2017 and later died in the legislature. Gov. Newsom also proposed to earmark $25 million for safe drinking water, to jump-start the effort. This tax would result in an extra water fee on each person or entity that purchases water from a public water system. Low-income households would be exempted from this fee and this proposal would prioritize the use of this funding to assist disadvantaged communities.

A Constitutional Amendment

Many legislators, such as Assemblyman Phil Ting, oppose the Governor's proposal because it would be difficult to support a tax on all Californians, most of whom have clean drinking water, to pay to fix pollution in a very specific area. Some lawmakers proposed other means of funding water projects that do not result in increasing fees paid by consumers. One proposal, set forth by Assemblyman Mathis, comes in the form of a constitutional amendment. Under this amendment, the government would be required to set aside at least 2 percent of the state's budget for the paying down of water bonds and addressing water infrastructure issues. The proposed amendment further delineates a funding split with the Department of Water Resources and the SWRCB for the purpose of providing funding for water projects.

Conclusion and Implications

Poor access to clean water in disadvantaged communities has been an area of growing public concern. The California Legislature continues to grapple with crafting a solution. The current state administration led by Governor Newson appears to be keeping water quality issues at high priority, which is anticipated to lead to further action by the California Legislature. (Maya Mouawad, Steve Anderson)

REGULATORY DEVELOPMENTS

U.S. BUREAU OF RECLAMATION RELEASES BIOLOGICAL ASSESSMENT FOR CALIFORNIA WATER OPERATIONS

On February 4th, 2019 the U.S. Bureau of Reclamation (Bureau) sent a Biological Assessment (BA) for the re-initiation of consultation on the coordinated long-term operation of the federal Central Valley Project (CVP) and California's State Water Project (SWP) to the U.S. Fish and Wildlife Service and the National Marine Fisheries Service (collectively: Fisheries Agencies). Completion of the BA is an important step in the ongoing re-consultation regarding operations of the CVP and SWP. It will provide the basis for the Fisheries Agencies to issue revised Biological Opinions (BOs) regarding project operations later this year.

Background

A Biological Assessment provides information to support consultation under the interagency cooperation requirements of § 7 of the federal Endangered Species Act (ESA). (16 USC § 1536.) Consultation under ESA § 7 is the mechanism by which federal agencies such as the Bureau and the Fisheries Agencies ensure that the actions they take, fund, or authorize do not jeopardize the continued existence of a listed species, or adversely modify habitat that has been designated as critical. When a federal agency such as the Bureau determines that an action is likely to adversely affect a listed species then it submits a request to the one or both of the Fisheries Agencies for formal consultation. (50 C.F.R. § 402.14.) That request is supported by BA, which provides a description of the proposed federal agency action, and analyzes the potential effects of the action on species that are federally listed as endangered or threatened, and which may occur in the action area and designated critical habitat for the species. (50 C.F.R. § 402.12.) The Fisheries Agencies will then prepare a BO that determines whether the proposed action is likely to jeopardize the continued existence of the species, or adversely modify habitat that has been designated as critical to the survival or recovery of the species. If so, the BO will identify contain any available reasonable and prudent alternatives to the proposed action which, if followed, would avoid that projected jeopardy or adverse modification. The federal action agency will then consider the conclusions of the BO in ensuring that it complies with its duty under ESA § 7 to avoid jeopardizing a species or adversely modifying critical habitat.

The CVP and SWP historically operated in tandem under the same BOs, because their operations are coordinated, even though the CVP is operated by the federal government and the SWP is operated by the state. The existing BOs for coordinated operations of the CVP and SWP were issued ten years ago. The provisions of the existing opinions, which include reasonable and prudent alternatives, resulted in the loss of a long term average of 1 million acre-feet of water supply per year for the CVP and SWP. The existing opinions were challenged in court, but ultimately upheld by the Ninth Circuit in *San Luis & Delta-Mendota Water Authority v. Jewell* 747 F.3d 581 (9th Cir. 2014) and *San Luis & Delta-Mendota Water Authority v. Locke* 776 F.3d 971 (9th Cir. 2014).

The Bureau and the Department of Water Resources (DWR) have been engaged in re-initiated consultation on CVP and SWP project operations since 2016. The re-initiated consultation incorporates new information provided by the recent historic drought and updated and evolving science. Under the currently projected schedule for the reinitiated consultation on long-term CVP and SWP operations, the Bureau expects that the Fisheries Agencies will be provide their Biological Opinions in June, 2019.

A parallel environmental review process under the National Environmental Policy Act (NEPA) is ongoing as well. According to the Bureau's timeline, the draft Environmental Impact Statement (EIS) will be available for public comment in June 2019, and public comment will conclude in August 2019. A Final EIS and Record of Decision are expected in in November 2019 and December 2019 respectively.

The Proposed Action

The proposed action as described in the BA is to:

> . . .continue the coordinated long-term operation of the CVP and SWP to maximize water supply delivery and optimize power generation consistent with applicable laws, contractual obligations, and agreements; and to increase operational flexibility by focusing on nonoperational measures to avoid significant adverse effects. (BA at 4-1)

The proposed action includes refinements or variations from current operations, including certain elements of the reasonable and prudent alternatives in the existing BOs. For example, with regard to exports of water pumped at the Delta, the proposed action would use risk-based management that incorporates real-time monitoring for fish presence and models, where possible, in place of calendar-based restrictions on pumping. A summary comparison of current operations and the proposed action is included in Table 4-1 of the BA, at pages 4-1 through 4-4. The proposed action is expected to allow for improved water supply for CVP and SWP contractors as compared to current operations under the existing Biological Opinions.

Impacts to Species and Habitat

To assess the impacts of the proposed action on listed species and their habitat, the BA uses a "without action scenario" as a basis for comparison. The BA explains the:

> . . .without action scenario entails no future operations of the system, including, for example, storing and releasing water from reservoirs and delivering water otherwise required by contract. (BA at 3-16.)

Under the without action scenario the CVP and SWP would not provide any water deliveries to water contractors. Nor would the projects be operated to provide environmental benefits, such as maintaining a cold water pool for fish downstream of dams, or maintaining minimum instream flows during naturally low flow periods. In essence, under the without action scenario inflow to reservoirs would be passed through the existing dams. The BA explains it used this without action scenario to isolate the effects of project operations from the many other factors that also affect listed species and their habitat. The BA projects that the proposed action would have overall beneficial effects for listed fish species and their habitat as compared to the without project scenario.

Conclusion and Implications

Issuance of the BA is an important step in the reconsultation on CVP and SWP operations. The approach taken in the BA reflects an effort to reexamine the assumptions and conclusions of the existing BOs, as well as to better isolate the effects of project operations.

The next critical step, expected in June 2019, will be issuance of a BO or opinions by the Fisheries Agencies. That will provide the Bureau and the DWR with the Fisheries Agencies' formal views on the effects of the proposed project operations, including their views on whether proposed operations would jeopardize the affected species or adversely modify critical habitat. If the Fisheries Agencies find the proposed project operations would jeopardize listed species or adversely modify their critical habitat, they will be required to identify any available reasonable and prudent alternatives.

The California Department of Fish and Wildlife (CDFW) will weigh in on whether its agrees with the conclusions of the Fisheries Agencies, exercising its authority under the California Endangered Species Act (CESA). DWR will likely ask CDFW to find that the federal BOs are consistent with CESA. (California Fish and Game Code § 2080.1.) If it does, DWR would not require any further authorization or approval under CESA for effects on state-listed species.

Past BOs on CVP and SWP operations have been controversial, and the coming new Biological Opinion or opinions will likely continue that trend. Environmental groups have been critical of the BA, and contend that proposed changes from current operations would add strain to the Central Valley's fish populations, including winter-run Chinook salmon and Delta smelt. Water users, in contrast, may contend that the new BOs are perpetuating restrictions on operations that have had significant costs for water supply but have not proven beneficial for fish populations.

In sum, as 2019 unfolds it is likely to bring significant new developments in the application of the ESA to CVP and SWP operations. The BA is available on the Bureau's website at: https://www.usbr.gov/mp/bdo/lto.html

(Holly Roberson, Dan O'Hanlon)

CALIFORNIA DEPARTMENT OF WATER RESOURCES RELEASES FINAL UPDATED GROUNDWATER BASIN PRIORITIZATIONS

The California Department of Water Resources (DWR) recently released final basin prioritizations for 458 groundwater basins in California, marking another key step in the implementation of the landmark California Sustainable Groundwater Management Act of 2014.

Background

In 2014, the California legislature passed the Sustainable Groundwater Management Act (SGMA), which requires local agencies to establish Groundwater Sustainability Agencies (GSAs) to manage basins sustainably and oversee the preparation and implementation of local Groundwater Sustainability Plans (GSPs). SGMA also requires DWR to classify basins and sub-basins into priority levels and to reassess the basin priorities any time DWR updates basin boundaries.

The Process

Basins are categorized as "high," "medium," "low" or "very low" priority pursuant to criteria set forth in the Water Code such as the basin's population, irrigated acreage, the number of wells and other criteria. In 2015, DWR relied upon existing basin prioritization information developed through California Statewide Groundwater Elevation Monitoring (CASGEM) program. The following year, DWR published basin boundary modifications through the Bulletin 118 Interim Update 2016 (Bulletin 118). The recent basin prioritization process began in 2018 (2018 SGMA Basin Prioritization) and also reflects required SGMA considerations such as adverse impacts to habitat and streamflow, the presence of adjudicated areas, basins' status as critically overdrafted and the extent and nature of groundwater related transfers.

There are 517 identified groundwater basins and sub-basins in the State of California. The 2018 SGMA Basin Prioritization has been divided into two phases. The first phase (released January 4, 2019) prioritized 458 basins based on the 2016 basin boundary modifications in Bulletin 118. This phase began on May 18, 2018 with the opening of the public comment period, and was finalized on January 4, 2019. During this process, DWR held four public meetings that received over 500 individual comments.

The second phase will prioritize the remaining 59 basins based on 2018 basin boundary modifications. The release of final prioritization for these basins is expected to occur in late Spring of 2019.

DWR evaluated the priority level for each basin primarily according to eight categories. A scoring system based on the total accumulated points for all categories determined the priority designation. The categories included:

- The population overlying the basins or sub-basin.
- The rate of current and projected growth of the population overlying the basin or sub-basin.
- The number of public supply wells that draw from the basin or sub-basin.
- The total number of wells that draw from the basin or sub-basin.
- The irrigated acreage overlying the basin or sub-basin.
- The degree to which persons overlying the basin or sub-basin rely on groundwater as their primary source of water.
- Any documented impacts on the groundwater within the basin or sub-basin, including overdraft, subsidence, saline intrusion, and other water quality degradation.
- Any other information determined to be relevant by the department, including adverse impacts on local habitat and local stream flows.

Of the 458 basins that DWR reassessed, the majority maintained their previous priority ranking. Fifty-six (56) basins were elevated to "medium-" or "high-" priority, while 21 basins were reduced to "very low priority" (primarily due to the existence of large basin

areas covered by adjudications with existing governance and oversight in place).

Reasons for Change

Most changes to basin prioritization are a result of the modifications to the weight given to basins participating in groundwater-related transfers and water quality impacts. Changes were also a result from the use of different data or factors specific to SGMA. DWR indicated that changes were mostly likely to occur in the following situations:

- Where boundary modifications resulted in a significant realignment of population, groundwater use, or other factors that were critical in determining prior CASGEM Basin Prioritization;

- Where new or improved data established different use or reliance of groundwater than had been identified in the prior CASGEM Basin Prioritization; and

- Where other information, determined to be relevant to DWR for the purposes of SGMA, was included in the prioritization.

Requirements

The prioritization of a basin is significant because it determines whether the full extent of SGMA requirements are required. While certain aspects of SGMA apply to all basins, only high- and medium-priority basins are required to form GSAs and be managed in accordance with GSPs, or an alternative to GSPs. Low- and very low-priority may, but are not required, to establish GSAs and adopt GSPS.

Basins reclassified as high- or medium-priority in the 2018 Basin Prioritization will be required to form a GSA within two years from the date the basin's priority is finalized and are required to submit a GSP five years from the same finalization date. A high- or medium-priority basin reclassified as low- or very low-priority will no longer be required to adopt a GSP or submit an alternative, though they may voluntarily elect to do so.

Conclusion and Implications

The release of the 2018 SGMA Basin Prioritization incorporates many jurisdictional and scientific modifications and considerations. These reclassifications determine whether a basin will need to continue to comply with SGMA by forming GSA and adopting a GSP, or may instead do so voluntarily. Basins required to comply with these SGMA requirements are expected to reach sustainability generally within 20 years of implementing their GSPs. (Paula Hernandez, Michael Duane Davis)

LAWSUITS FILED OR PENDING

STATE WATER BOARD SUED ON GROUNDS THAT ITS APPROVAL OF AMENDMENTS TO THE BAY-DELTA PLAN INSUFFICIENTLY PROTECT FISH

On January 25, 2019, a coalition of environmental, fishing, and Native American groups led by the Pacific Coast Federation of Fishermen's Associations (collectively: petitioners) filed suit against the State Water Resources Control Board (SWRCB) (Sacramento Superior Court, Case No. 34-2019-80003063). The petitioners allege the SWRCB's adoption of amendments to the Bay-Delta Plan on December 12, 2018 violate the California Environmental Quality Act (CEQA), the federal Clean Water Act, California's Porter Cologne Act, and the public trust doctrine by, among other things, failing to require 60 percent unimpaired flows on lower San Joaquin River and its tributaries.

Background

On December 12, 2018, the SWRCB, acting pursuant to its obligations under the federal Clean Water Act, Porter-Cologne, and pursuant to its public trust obligations, adopted certain amendments to the Bay-Delta Plan (Amendments) related to the Lower San Joaquin River and its tributaries. The Amendments generally: 1) require 40 percent of unimpaired flow from February through June, based on a minimum seven-day running average, from the Stanislaus, Tuolumne, and Merced rivers; and 2) establish a salinity objective in the southern Delta of 1.0 deciSiemens per metre (dS/m EC) during April through August. In conjunction, the SWRCB certified a Substitute Environmental Document (SED) related to the Amendments.

Petitioners' Allegations

Petitioners have asserted five causes of action against the Board.

CEQA Claims

First, petitioners claim the SWRCB's adoption of an alternative that requires 40 percent unimpaired flow was improper under CEQA because other alternatives had higher base flows (*e.g.* 60 percent unimpaired flow) and would be more likely to provide benefits for fish. Petitioners further allege that none of the alternatives analyzed in the SED are actually sufficient because none are in fact sufficient to achieve fish recovery. Petitioners continue that the SED violates CEQA because the SED's analysis "overstate[s] the potential harms to agriculture" because there is no analysis of potential "improved irrigation practices" that would reduce water demand from agriculture.

Further, according to the petitioners the SED violates CEQA because the SED improperly segmented analysis of the Board's required action by analyzing only the Bay-Delta amendments that related to the Lower San Joaquin River. Petitioners claim the SWRCB was required to analyze all actions related to amending the Bay-Delta Plan at once, and that dividing the amendments between the San Joaquin watershed on one hand , and the Sacramento watershed and eastside delta tributaries on the other is impermissible under CEQA.

Clean Water Act, Porter-Cologne Claims

In its second and third causes of action, petitioners allege the salinity objective adopted by the SWRCB—1.0 dS/m EC during April through August—violates the federal Clean Water Act, Porter-Cologne, and the SWRCB's anti-degradation policy. According to petitioners, the new salinity objective will result in lower water quality that violates federal standards and unreasonably affects present and anticipated beneficial uses of water. Petitioners claim the SWRCB's delay in enforcement has led to the standard being repeatedly exceeded in the past, and that water quality conditions resulting from such lack of action cannot form the baseline for analyzing whether degradation will occur under the new standard.

Public Trust Claim

Petitioners' fourth cause of action asserts the board violated its public trust obligations by adopting unimpaired flow requirements that are less than 60 percent. In support, petitioners claim 60 percent unimpaired flow was the amount found necessary to protect public trust resources such as fish. Petitioners further contend the SWRCB violated the public trust by considering farmland irrigation—which the petitioners claim is a non-public trust use—over the needs of fish and wildlife.

Other Relief Sought

The petition's fifth cause of action is for writ of mandate and declaratory and injunctive relief to set aside the SWRCB's approvals based on the arguments outlined above.

Conclusion and Implications

The PCFFA *et al.* petition was filed in Sacramento Superior Court after the SWRCB adopted its amendments to the Bay-Delta Plan on December 12, 2018. In addition to the PCFFA *et al.* petition, agricultural and municipal water users have filed petitions challenging the SWRCB's action on December 12, 2018. Given the similar facts and legal issues involved, it is possible that the actions will be consolidated or coordinated before one judge. In addition, after March 1, 2019 the SWRCB is expected to further consider a settlement framework proposed at the December meeting by California Department of Fish and Wildlife and the California Department of Water Resources. It remains to be seen whether the Amendments and the certified SED challenged by PCFFA *et al.* and the other water users will stand or potentially be replaced by an entirely different regulatory framework predicated on a settlement framework.
(David E. Cameron, Meredith Nikkel)

RECENT FEDERAL DECISIONS

D.C. CIRCUIT FINDS STATES WAIVE CLEAN WATER ACT WATER QUALITY CERTIFICATION LEVERAGE WHEN THEY CONTRACTUALLY AGREE TO DELAY CERTIFICATION FOR MORE THAN ONE YEAR

Hoopa Valley Tribe v. Federal Energy Regulatory Commission, 913 F.3d 1099, (D.C. Cir. 2019).

In a seemingly pedestrian statutory-interpretation ruling, on January 25, 2019, the D.C. Circuit undercut a widespread tactic by which states, project applicants, and interested third parties have used their water quality certification authority to routinely delayed federal dam licensing proceedings.

Background

In 1954, the Federal Energy Regulatory Commission (FERC) licensed a "hydropower project ... consisting of a series of dams along the Klamath River in California" (Project), pursuant to Subchapter I of the Federal Power Act (FPA), 16 U.S.C. § 791a–823g. As the "licensing, conditioning, and development of hydropower projects on navigable waters" pursuant to the FPA "may result in any discharge into the navigable waters," water quality certification under the federal Clean Water Act (CWA) § 401 (33 U.S.C. § 1341(a)(1)) is a precondition to FERC's issuance of a license or other FPA-approval. The CWA provides that the "state certification requirements 'shall be waived with respect to'" a FERC application:

> . . .if the state 'fails or refuses to act on a request for certification, within a reasonable period of time (which shall not exceed one year) after receipt of such request.' . . . .[T]he purpose of the waiver provision is to prevent a State from indefinitely delaying a federal licensing proceeding by failing to issue a timely water quality certification under Section 401. *Alcoa Power Generating Inc. v. FERC*, 643 F.3d 963, 972 (D.C. Cir. 2011).

In this matter, the original license expired in 2006; PacifiCorp, the successor in interest to the dams, has since operated the Project under "annual interim licenses pending [a] broader licensing process." PacifiCorp's proposed "broader licensing" included decommissioning various downstream dams, presumable on the basis that bringing them into compliance with modern environmental standards would not be cost-effective; the upstream dams would be modernized and relicensed. Currently, "[a]ll milestones for relicensing have been met except for the states' water quality certifications under Section 401."

In 2010, California, Oregon, various environmental groups, business interests and Native American tribes entered into

> . . .a formal agreement in 2010, the Klamath Hydroelectric Settlement Agreement [KHSA or the Agreement], imposing on PacifiCorp a series of interim environmental measures and funding obligations, while targeting a 2020 decommission date.

Under the KHSA, the states and PacifiCorp agreed to defer the one-year statutory limit for § 401 approval by annually withdrawing-and-resubmitting the water quality certification requests that serve as a pre-requisite to FERC's overarching review. The Agreement explicitly required abeyance of all state permitting reviews.

A 2016 amendment to the KHSA provided for the dams slated to be decommissioned to be transferred to a separate entity, and in 2018 FERC approve splitting the licensing proceedings, but has not yet approved the transfer of the annual, interim licenses (and pending application for decommissioning) to a new entity.

The Hoopa Valley Tribe was not a party to the original or amended KHSA. In 2012, the Tribe:

> . . .petitioned FERC for a declaratory order that California and Oregon had waived their Section 401 authority and that PacifiCorp had correspondingly failed to diligently prosecute its licensing application for the Project.

That petition and a 2014 rehearing request were both denied by the agency; the Tribe then sought review by the D.C. Circuit Court of Appeals. The D.C. Circuit Court held the matter in until the amended KHSA had been adopted, but as:

> . . .the decommissioning the agreement contemplated has yet to occur, and in light of Hoopa's pending petition, [the Court] removed the case from abeyance on May 9, 2018.

The D.C. Circuit's Decision

The D.C. Circuit formulated the issue before it as:

> . . .whether a state waives its Section 401 authority when, pursuant to an agreement between the state and applicant, an applicant repeatedly withdraws-and-resubmits its request for water quality certification over a period of time greater than one year. If this type of coordinated withdrawal-and-resubmission scheme is a permissible manner for tolling a state's one-year waiver period, then (1) California and Oregon did not waive their Section 401 authority; (2) PacifiCorp did not fail to diligently prosecute its application; and (3) FERC did not abdicate its duty. However, if such a scheme is ineffective, then the states' and licensee's actions were an unsuccessful attempt to circumvent FERC's regulatory authority of whether and when to issue a federal license.

As an exercise in statutory construction, the Court of Appeals described its task as "undemanding inquiry because Section 401's text is clear"—waiver occurs if a state:

> . . .fails or refuses to act on a request for certification, within a reasonable period of time (which shall not exceed one year) after receipt of such request.

The inclusion of a temporal element defines "the absolute maximum" time a state can take to act without waiver occurring as one year:

> Indeed, the Environmental Protection Agency ("EPA")—the agency charged with administering the CWA—generally finds a state's waiver after only six months. Citing 40 C.F.R. § 121.16.

Here, the states have kept the licensing-decommissioning proceedings in suspended animation for more than a decade by annually, since 2006, withdrawing and refiling identical applications "*in the same one-page letter*" (emphasis by the court). Thus, the Court of Appeals did not have to decide if submitting "a wholly new" application would trigger a new one-year certification period, or just how different a refiled request must be to qualify as "new."

While the opinion is technically narrow, disallowing "California and Oregon's deliberate and contractual idleness" in furtherance of "a coordinated withdrawal and resubmission scheme," its practical impact is potentially broad:

According to FERC, it is now commonplace for states to use § 401 to hold federal licensing hostage. At the time of briefing, 27 of the 43 licensing applications before FERC were awaiting a state's water quality certification, and four of those had been pending for *more than a decade*.

Conclusion and Implications

The byzantine delays and intricacies involved in many environmental permitting proceedings, followed inevitably by litigation, all of which provide ample entry points for third parties to gain leverage, make the kind of contractual circumventions of statutorily-proscribed procedures attractive when a global settlement is on the table. Weighing whether to enter into any such deal should always include a cold-eyed assessment of whether there are any interested parties not included in the deal, and whether the courts may disagree with the legal theories and assumptions underlying the parties' bargain. The D.C. Circuit's decision is available online at: https://www.cadc.uscourts.gov/internet/opinions.nsf/DC412967A23D8B368525838D0052E4CD/$file/14-1271-1770168.pdf
(Deborah Quick)

RECENT CALIFORNIA DECISIONS

SACRAMENTO SUPERIOR COURT UPHOLDS ENVIRONMENTAL REVIEW FOR POSEIDON DESALINATION PROJECT

California Coastkeeper et al v. California State Lands Commission,
Sacramento Superior Court Case No. 34-2017-80002736 (Sac. Super Ct. 2019).

In January 2019, the Sacramento Superior Court dismissed a California Environmental Quality Act (CEQA) challenge to the State Lands' Commission's (SLC) 2017 approval of a lease amendment under which a Huntington Beach desalination project proposed to operate. The decision, *California Coastkeeper et al v. California State Lands Commission* removes one hurdle for the project, which must still obtain regulatory approvals from the Regional Water Quality Control Board. The decision by Judge Sueyoshi of the Sacramento Superior Court also offers a detailed analysis of the distinctions between "supplemental" and "subsequent" environmental review under CEQA—a distinction that is informative to water agencies in all stages of infrastructure and environmental review planning.

Background

In 2010, acting as the lead agency under CEQA, the City of Huntington Beach (City) certified an Environmental Impact Report (EIR) for the "Seawater Desalination Project at Huntington Beach." The EIR evaluated the addition of a desalination facility at a then-existing powerplant, as well as offshore improvements necessary to carry out the desalination work. The City took that action in its role as lead agency for the project under CEQA.

The tidelands within which the desalination facilities were proposed to operate were subject to a 2007 lease between the powerplant operator and the State Lands Commission. Following the approval of the project's EIR, the State Lands Commission (acting as a CEQA responsible agency, and in reliance on the EIR), approved a lease amendment that added Poseidon Resources as a co-lessee on the project site.

In 2016, Poseidon applied for another amendment to the SLC lease, the purpose of which was to allow for modifications to the desalination facility design to include (among others) the placement of 1 millimeter screens on the facility's existing intake pipes. The SLC determined that these changes, and intervening efforts to comply with the State Water Resources Control Board's 2015 Desalination Amendment, were sufficient to trigger the requirement for a supplemental EIR, which was released in 2017. The 2017 Supplemental EIR relied upon the analysis in the 2010 EIR for the project, and new material focused on the "minor changes with the Commission's lease area" to the previously approved desalination plant structures and operations.

The SLC approved the lease amendment, subject to the future approval of the Santa Ana Regional Water Quality Control Board. That application remains pending.

Challenges to the SLC Environmental Review

In November 2017, petitioners California Coastkeeper Alliance, California Coastal Protection Network, and Orange County Coastkeeper (petitioners) filed a petition for writ of mandate, challenging the SLC's approval of the lease amendment and challenging the sufficiency of that agency's review under CEQA.

Petitioners argued that the lease amendments and anticipated changes to the desalination plant's proposed operations were "substantial changes" requiring "major revisions" of the project's EIR under Public Resources Code § 15162, and further that the SLC was required under Public Resources Code § 15052 to assume a lead agency role in the preparation of that environmental review. In addition, petitioners argued that the SLC violated its duties under the public trust doctrine to consider and evaluate the proposed project.

The Superior Court's Decision

CEQA Claims

The court rejected each of these arguments in turn. First, CEQA requires that a new, subsequent EIR be

prepared only in those situations where: 1) *substantial changes* in the project analyzed or the impacts associated with it, which will require "major revisions" to the prior environmental review, are discovered; or 2) new information, which was not known at the time of the original documents' preparation, is uncovered. Pub. Res. Code § 21166; CEQA Guidelines § 15162. In the alternative, where "only minor additions or changes would be necessary" to make the prior environmental document applicable to the changed circumstances, a supplemental EIR may be prepared. CEQA Guidelines § 15163.

The court observed that SLC's decision to prepare a supplemental EIR, rather than a subsequent document, was a factual determination subject to the substantial evidence standard of review. Petitioners failed to demonstrate that the SLC's decision to proceed with a supplemental EIR was not supported by substantial evidence. As to certain of the changes in the project's design and operations, the court opined that these changes were either too speculative (*e.g.* future use of the treated water for groundwater supplementation). As to many of the challenged insufficiencies in the project's environmental review, petitioners had failed to identify evidence favorable to the other side, and explain why that evidence was lacking.

Public Trust Claims

Petitioners' public trust claims were tied to the related claim that the SLC had failed to properly evaluate the project and its impacts under CEQA. The court rejected these claims as well, finding that the SLC through its Supplemental EIR had "engaged in a thorough analysis of the proposed project, as well as a specific public trust analysis." (Slip Op., p. 18). Because petitioners failed to demonstrate that the SLC's decision was arbitrary and capricious, this challenge also failed.

Conclusion and Implications

In addition to representing forward progress for a significant new desalination project, *California Coastkeeper et al v. California State Lands Commission* offers a rare and detailed analysis of distinctions between a supplemental and subsequent EIRs. Given the long time scale and often inter-related nature of environmental review on water infrastructure projects, this discussion may be informative to other water agencies in their planning. In addition, future appeals of the Sacramento Superior Court decision may serve to further develop case law on the distinction between supplemental and subsequent EIRs. Judgment was filed in the case on February 1, 2019, and appeals may be filed through the spring.
(Rebecca Smith, Meredith Nikkel)

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