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by

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THE CENTRAL VALLEY PROJECT IMPROVEMENT ACT: AN URBAN PERSPECTIVE

Carl Boronkay and Timothy Quinn***

INTRODUCTION

The Central Valley Project ("CVP") Improvement Act (Title XXXIV of Public Law 102-575) represents a pivotal event in the history of water policy and law in California. Indeed, more than any other single event in the past quarter century, the CVP Improvement Act ("the Act") is a symbol of dramatic change, of new directions in policy, and of shifting political interests and alliances in the water and environmental communities.

The CVP Improvement Act will fundamentally change the way the project is operated. Under the Act, the CVP, once the exclusive domain of Central Valley agricultural interests and a handful of municipal and industrial contractors, will be operated to benefit a much broader spectrum of California interests, including California's environment and the statewide water-short urban economy. The Act further introduces basic

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economic reforms to narrow the gap between the cost to the taxpayer of supplying CVP water and the prices paid for the water by CVP water users. Under the Act, CVP contracts may be renewed after completion of an ambitious Environmental Impact Statement, but only for a period of twenty-five years (section 3404(c)), compared to the existing forty-year contract period. At the time of renewal, several contractual provisions must be included to promote more efficient use of water, including metering of water deliveries (section 3405(b)), tiered water prices (section 3405(d)), and water conservation standards (section 3405(e)).

For the environment, the Act includes: reauthorization language that expressly adds "the mitigation, protection, and restoration of fish and wildlife" as project purposes (section 3406(a)); provisions that dedicate water to be used primarily for fish and wildlife purposes (section 3405(b)); and provisions that require fish and wildlife habitat improvements throughout the CVP service area (section 3406(b)).

For urban areas, particularly those in Southern California and the San Francisco Bay Area which have not had access to CVP water in the past, the Act creates a new source of water supplies through voluntary water marketing arrangements with CVP farmers and contracting districts (section 3405(a)). For CVP farmers, the water marketing provisions create a new business opportunity in which the farmer/businessperson may elect to sell a portion of his water on a short-term or long-term basis to an urban (or other) buyer to increase the overall profitability of the farming enterprise. For urban water agencies and the urban economy, the passage of the legislation marks the first real progress toward securing additional reliable water supplies from the rivers and tributaries in the Central Valley and the Sierra Nevada since the construction of the first stage of the still incomplete State Water Project more than two decades ago.

As with most fundamental change, the CVP Improvement Act was the result of lengthy, intense negotiations involving numerous agricultural, urban, and environmental interests. Not surprisingly, the Act was also the product of a great deal of conflict — conflict that arose inevitably out of shifting political alliances and the increasing scarcity that will continue to mark California water issues and policy as we enter the twenty-first century.

I. CHANGING INTERESTS AND POLITICS

During the debate regarding CVP reform, agricultural leaders expressed deep concerns, even feelings of betrayal, regarding the changing political alliances in California water, notably that urban water inter-

ests particularly in Southern California had abandoned traditional alliances with San Joaquin Valley agricultural interests and realigned themselves with long-time critics of the water industry in the environmental community. Ultimately, urban water interests and many business leaders throughout the state strongly supported CVP reform legislation, particularly the water marketing provisions of the bill. It is important, however, to recognize that these shifting alliances were an inevitable consequence as urban water managers and others sought to protect and advance their interests under dramatically changing circumstances.

Historically, western water law and policy was developed primarily with the interests of agriculture in mind. These historic policies were heavily oriented toward construction of new water projects to allow the diversion and use of water resources primarily for irrigation purposes in distant locations away from the stream. Under this regime, the prior appropriation doctrine arose to protect the right of a diverter (typically, an irrigation district) to continued use of appropriated water so long as the use was reasonable and beneficial. If others required more water, competition for previously appropriated resources was for practical purposes proscribed. Growing water needs were met with further appropriations and the construction of additional water projects to remove more water from the natural environment.

Two powerful changes have forced a fundamental realignment in these historic western water policies. The first is urban growth; the second is the environmental revolution.

A. Urban Growth

Urban growth has been the defining socioeconomic characteristic of the western states, including California, during the post World War Two era. The western states, with economies once dominated by agriculture, are today among the most highly urbanized regions in the world. During the past quarter century, the California urban economy, in both the northern and southern parts of the state, has grown at approximately twice the growth rate of the national economy. Despite the recent recession, population growth is expected to continue for the next quarter century in California.

Accompanying the growth of the urban economy has been a steadily increasing imbalance between economic production and water use. Today, California agriculture uses more than 80 percent of the state's developed water supplies, while directly contributing only about 2.5 percent of the state's economic production. The contrast between water use

and economic production is even greater when considering the relatively lower-valued field crops grown in California, including cotton, rice, alfalfa, pasture, and various grains. These crops consume about 55 percent of the state's developed water supplies, while directly providing only about 0.5 percent of the state economy.

Urban areas in the West were incidental beneficiaries of the historic water policies. Urban water users required only a small fraction of the developed water and were willing political allies with agricultural interests to assure the construction of additional projects and the appropriation of additional water. Since the mid-1970's, however, these policies have not met the needs of the urban economy, which has suffered serious shortages in at least some parts of the state during eight of the past sixteen years. The changing makeup of California requires a shift in policy that is more responsive to the needs of the urban water user to assure a healthy statewide economy.

B. The Environmental Revolution

The environment was largely a forgotten concern under the old regime, which had developed around a premise that water left in the natural environment was valueless in economic terms. The constant pressure for additional projects and appropriations of this "free" resource contributed to the environmental stress that has shaken the old regime to its core. During the past two decades, the environmental movement has forever changed the rules of water supply acquisition. In essence, the environmental movement has successfully implemented legislative and administrative policies that force water users to recognize the value of water in the natural environment. In the process, the ability to develop additional supplies predominantly through new construction projects has been practically eliminated.

These powerful forces for change set the stage for rivalry and conflict and for the development of a new policy direction. The old days of balancing water demands and supplies by simply appropriating more water from nature are gone. Instead, Californians must reckon with a new era of competition. The ultimate success of the environmental movement has been the recognition that environmental uses of water are highly valuable and must be one central concern of water policy. Hence, the very notion of unappropriated water no longer has policy relevance in California. As a result, evolving policy will be forced to recognize a high degree of scarcity in water resources.

In the future, all three interest groups — urban, agricultural, and environmental — will necessarily have to compete with each other for

scarce water resources. The amount of use in one sector will require an evaluation of the value of water in the other sectors, indeed, even with competing uses in the same sector. The CVP Improvement Act, particularly its water marketing provisions, represents the first serious effort to develop policies to better manage the emerging competitive forces in California water.

II. WATER MARKETING PROVISIONS OF THE CVP IMPROVEMENT ACT

Section 3405(a) of the Act sets forth the basic policy with regard to the voluntary marketing of CVP water. The law states:

WATER TRANSFERS — In order to assist California urban areas, agricultural water users, and others in meeting their future water needs, subject to the conditions and requirements of this subsection, all individuals or districts who receive Central Valley Project water under water service or repayment contracts, water rights settlement contracts or exchange contracts entered into prior to or after the date of enactment of this title are authorized to transfer all or a portion of the water subject to such contract to any other California water user or water agency, State or Federal agency, Indian Tribe, or private nonprofit organization for project purposes or any purpose recognized as beneficial under applicable State law. Except as provided herein, the terms of such transfers shall be set by mutual agreement between the transferee and the transferor.

This provision of law contains several key elements that portend profound change in California water policy.

A. *Place-of-Use Restrictions*

Perhaps most fundamental, section 3405(a) abolishes the traditional geographic restriction that CVP water must be used only within the CVP service area, as defined by place-of-use restrictions on current water rights permits held by the Secretary of Interior. Such restrictions were regarded as fundamental protections under the old legal regime, but have the effect of precluding broader geographic competition for water resources. While any transfer of CVP water must secure necessary changes in the place-of-use and the purpose-of-use under applicable state water rights permits, the clear intent of Congress is to remove geographic restrictions on the use of CVP water and to allow competitive market forces to help allocate the use of CVP water throughout the state of California.

B. User-Initiated Transfers

By allowing transfers to be initiated by “all *individuals* or districts who receive CVP water,” the Congress took a fundamental reform step toward privatization of water allocation decisions. This change in policy was essential to match the financial incentive of the marketplace with the ability of the individual water-user/farmer to change irrigation practices and make water available for voluntary transfer to higher-valued uses elsewhere. This empowerment of individual water users was highly controversial because it implies a reduction in the power of public agencies, which have historically had absolute power regarding the ability to transfer water outside district boundaries. From an economic perspective, however, extending the right-of-use of individual water users to include the right to transfer water is an inevitable and desirable response to the increased scarcity of and competition for California’s water resources.

User-initiated transfers also raised concerns about possible third-party impacts. In particular, there was concern that agreements to fallow land might adversely affect entities in the local agricultural economy who were not directly involved in the decision to transfer water. However, available evidence introduced into the policy debate strongly suggested that these impacts, while a legitimate policy concern, would be quite small and well within the range of normal market fluctuations. To assure that market activity is not unreasonably concentrated geographically, which could under some circumstances result in unacceptable third-party impacts, section 3405(a)(1) provides that “[t]ransfers involving more than 20 percent of the CVP water subject to long-term contract within any contracting district or agency shall also be subject to review and approval by such district or agency subject to conditions specified in this subsection.”

C. Environmental Water Purchases

Earlier versions of the CVP reform legislation contained provisions that would have dedicated to fish and wildlife purposes as much as 1.5 million acre-feet annually of CVP yield, with no compensation to existing water users who would receive reduced supplies. Ultimately, the compromise provisions that became law established a policy to achieve environmental objectives with a combination of dedicated water (up to 800,000 acre-feet annually) and water purchased on a voluntary basis from CVP or other water users.

Section 3405(a) clearly contemplates the possible purchase of CVP water for fish and wildlife purposes by state or federal resource agen-

cies and even by private nonprofit environmental organizations. Further, section 3407 creates the *Central Valley Project Restoration Fund*, which, in part, provides substantial financial resources for the purchase of water for environmental purposes. Section 3407(c)(2) establishes an objective of average annual contributions to the fund of \$50 million (October 1992 price levels), with fees of up to \$30 million annually on CVP water and power users and the remaining funds to be raised from a \$25 per acre-foot assessment on water transfers and other sources. Section 3407(a) effectively requires that at least two-thirds of these monies, or up to \$33 million annually on the average, must be spent to purchase water or otherwise accomplish the flow-related provisions of the Act.

This reliance on the market, not only to allocate water among urban and agricultural uses, but also to achieve environmental objectives, may be one of the most innovative aspects of the legislation. This provision will require the fair compensation of at least some existing water users when water resources are redirected for environmental uses. From an economic efficiency perspective, requiring that a significant fraction of environmental water be purchased on a voluntary basis will help minimize the economic impacts of reallocating water to the environment. This policy approach is clearly consistent with the theme of increased competition for water resources among all three use categories. The policy of purchasing environmental water not only recognizes the need for competition among existing urban and agricultural uses, but will also encourage environmental decision-makers to account for the value of water in other uses when it is reallocated to fish and wildlife purposes.

D. District and Water User Protections

While fostering a relatively free market for the voluntary transfer of CVP water, section 3405(a)(1) of the Act establishes specific criteria for transfers to protect other water users, the districts, and the environment from adverse impacts when transfer agreements are implemented. To assure that these protections are adhered to, all transfers under the Act require the review and approval of the Secretary. As noted above, transfers involving more than twenty percent of a district's CVP supply also require review and approval by the contracting district or agency.

Sections 3405(a)(1)(A) and (I) require that all transfers to buyers outside the area of origin be subject to a "real water" test, a provision essential to protect other water users and the environment from adverse impacts. Section 3405(a)(1)(K) provides general protections by requir-

ing that no transfer shall be approved unless "such transfer will have no unreasonable impact on the water supply, operations, or financial conditions of the transferor's contracting district or agency or its water users." Other provisions assure that transfers will not adversely affect water rights (section 3405(a)(1)(E)); provide a right-of-first-refusal to assure that water is not transferred outside the project if other entities within the CVP service area have equally valuable uses and elect to purchase the water (section 3405(a)(1)(F)); protect against adverse groundwater impacts (section 3405(a)(1)(J)); and prevent transfers from unreasonably affecting the quantity or quality of water available for fish and wildlife resources (section 3405(a)(1)(L)).

III. CONCLUSION

Passage of the CVP Improvement Act is only the beginning of the change in California water. While the agreement on the policies in the legislation represented a breakthrough, much work remains on the development of regulations to effectively implement the environmental and water marketing provisions of the Act. In addition, while the CVP is the largest water project in California, it delivers only about twenty percent of the developed water in the state. Similar legislation is essential for the remaining eighty percent of California's water resources.

Ultimately, however, we believe that the CVP Improvement Act will be viewed in decades to come as the crowning water policy achievement in the last decades of the twentieth century. No less than the achievements of those water leaders of the past who defined an era of water development and related prosperity, those who struggled to develop a new policy direction emphasizing water management and environmental stewardship have laid the foundation for a prosperous future for California.