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PRESENTED TO:

**Little Hoover Commission
Hearing on State Water Governance**

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California's Current Water Management Governance Structure

One topic that has received recent attention from this Commission is whether there might be better governance structures for the management of California's water resources. More specifically, this Commission has asked whether management of the State Water Project (SWP) by the Department of Water Resources (DWR) creates impediments or conflicts with its other more general state-wide responsibilities for water resources planning.

Any discussion of separating or otherwise altering the management relationship of the SWP from DWR requires robust analyses of the impacts upon DWR's core water management responsibility.

The Commission received testimony on the topic of water governance at its April 23 hearing earlier this year, and also is scheduled to receive related testimony today from a variety of perspectives. DWR welcomes the opportunity to share its ideas for addressing this important topic and looks forward to the Commission providing the results of its efforts.

Background

DWR operates the SWP as a state-owned utility, competing in the appropriate markets with other utilities for operational and human resources, while also meeting its legislatively mandated trustee responsibilities for transparency and public interest. The planning, engineering, operation, maintenance, and management costs of the SWP are reimbursed, in accordance with enabling state legislation. Currently, annual SWP costs exceed \$1 billion. With the exception of some recreation and fish and wildlife enhancement activities, the state General Fund is not responsible for operation costs of the SWP.

The SWP is the largest state-built, multipurpose water project in the United States. DWR has had responsibility for the management, design, construction operation and maintenance for over 50 years. Water captured and stored in SWP facilities is released from reservoirs to meet a variety of statutory requirements for contractual water supply, power generation, flood control, water quality improvement, and recreation and fish and wildlife enhancement. Twenty-nine public agencies composing the SWP water contractors have signed long-term contracts with DWR for SWP water deliveries to northern, central, and southern California.

In the process of delivering water to areas of need, the SWP generates vast amounts of energy, but also creates an even bigger need for energy to run its massive pumps. DWR is able to either use its generation for SWP pumping demands or to produce revenue to offset operating costs, thus reducing water delivery costs to end users. As the single largest consumer of energy and the fourth largest hydroelectric generator in California, the SWP has a significant role in the management and transmission of statewide electrical energy sources.

Critique of the Status Quo

Despite being a state agency with a unique mission, DWR's State Water Project operation is subject to the same oversight regulations from the Department of Personnel Administration, Department of General Services, Department of Finance, and the State Personnel Board as any other state agency. The standard review times and protocols employed by these agencies are often not conducive to the unique requirements of a state run utility and frequently place DWR at a disadvantage in meeting the business and operational needs of the SWP.

Two specific examples of how the SWP is at a disadvantage are:

1. A 30-year transmission interconnection agreement with Southern California Edison (SCE) was expiring and DWR negotiated a new agreement for another 30 years.

The Department of General Services (DGS) denied the 30-year term and forced DWR to only contract for 5 years on the basis that there might be new opportunities or others that could provide this service in 5 years. DGS obviously did not understand the transmission structure. DWR explained to DGS that another entity is not going to speculate and invest millions in building a parallel transmission line and that the rates are reviewed and approved by the Federal Energy Regulatory Commission as to reasonableness. This contract will expire within the next year and DWR's limited staff will need to go through the same process again. Also, by having this short term, allows SCE to revise their rates or state that there are additional system impacts that we have to pay for.

2. Another detriment is the inability to access robust and active electronic energy trading markets. The host of this electronic trading platform requires their form of agreement to be signed by all participants and they are unwilling to negotiate the terms of their standard agreement. As such, the SWP is blocked from transacting with a segment of the energy market, especially in a real-time situation where there are a limited number of participants outside of the electronic exchange. We estimate this has resulted in the SWP paying over \$5 million more in power costs per year.

As a result, avoiding impacts to the continued safe and reliable operation of the State Water Project is now a major concern among those in DWR who have responsibility for its operation. That concern is magnified when considering the new operational challenges for the SWP in response to climate change, drought, environmental protection, judicial orders, and new regulatory requirements.

As a routine business practice, DWR continuously initiates business and engineering improvements (both internal and contracted) to its management, operation, and maintenance of the SWP. The efforts have historically allowed DWR to meet its goal of delivering affordable SWP water to over 23 million Californians in a safe and reliable manner. While noteworthy, DWR is discovering these successes are increasingly

restricted by administrative protocols DWR must utilize by virtue of being a state agency.

Although arguably meeting the needs of most state agencies, the protocols clearly were not written with DWR's unique role in operating the nation's largest state built water delivery system in mind. The business climate in which the SWP is operated frequently requires timely management reactions that are out of synch with the multi-layered review and approval process administered by external state control agencies.

Last year, DWR launched an internal study of how it might update its relationship with oversight agencies within state government to better meet the business needs of operating the SWP. The study began with a survey of past reports and studies describing how various business initiatives fared within the state agency approval process. These initiatives were often meant to address some of the same concerns this Commission has already heard from presenters regarding SWP personnel problems in the human resource areas of recruitment, compensation, position approvals, and contracting.

What is especially noteworthy from the survey is the emerging conclusion that a new governance structure for the SWP, and by implication, for DWR, should be investigated.

The early impetus for the DWR study had been to investigate governance alternatives to address SWP business limitations of its existing governance structure. However, it became clear that was only a partial benefit that a new governance structure can provide. Our study has since been expanded in scope to discuss how different governance structures can also preserve and enhance the overarching public interest responsibilities inherent in DWR's role as the state's premier water resource manager.

While DWR's study is not yet complete here are some early observations for consideration.

- At a minimum, a new governance structure should be responsive to the unique (to state government) SWP requirements of utility operation in the areas of human resources and contracting;
- The multi-purpose benefits of the SWP include water supply, energy supply, water quality, recreation, flood control, and fish and wildlife enhancement thus giving rise to a variety of interests that may need to be balanced in any alternative governance structure;
- Given the complexity and integration of the SWP supporting infrastructure within DWR, a phased approach to any alternative governance structure would need to be investigated and impacts to other programs of state importance must be assessed;
- Since G.O. bonds and other public financing were used for the construction of the SWP, the benefits derived must benefit the people of California. This public trust obligation of the SWP must continue and be retained in any form of governance;
- Assignment of water rights to DWR for the development of the SWP must be retained by the State as these rights preserve the public interest.

Efficiencies and Statewide Benefits of an Integrated Water Management Agency and State Water Project

While any alternative model, at a minimum, should improve the business functions underlying SWP safety and reliability concerns, it is also imperative that the preferred alternative include a discussion on how the public trust and resource stewardship values of DWR and the SWP will be preserved and protected. If any alternative would alter the traditional reporting relationship of SWP management to external

administrative bodies, policy and legislative issues should also be discussed, including which current benefits associated with state agency stewardship might be impacted.

A robust discussion should also address how to preserve the efficiencies that come from having the knowledge base and expertise supporting the SWP available to the state's general statewide water planning, flood protection and local assistance functions. Separation of the SWP, while perhaps accomplishing some goals, will almost certainly result in the duplication of some water management functions and the dissolution of centers of staff expertise and therefore should be studied with attention to these effects.

Separating the SWP from DWR could result in a variety of unintended consequences. The integration of the SWP within DWR currently provides for unique cross-training functions in the water resources engineering and scientific fields. For example, a DWR employee may work on a matrix-team style project to integrate the purchase and management of mitigation lands for flood projects with lands set aside for SWP mitigation purposes to achieve optimal swainson's hawk habitat. On a project like this, DWR is able to easily draw upon a wide variety of intradepartmental expertise from a number of divisions.

With any discussion of governance restructuring it is important that we proceed in a way that addresses and fully recognizes these concerns and more. The worst outcome for Californians would be one in which we make the state's water supply less reliable and more expensive under the pretense of doing the opposite.