

Memorandum

Date: March 31, 2016
From: Lawrence Kogan, Esq.
To: KID Board and Members
Re: **KID Compelled Under Duress to Immediately Execute Proposed One-Sided C Flume Replacement Financing Contract During March 24, 2016 BOR Meetings**

On March 24, 2016, at 11:00 am, a private meeting was held at the Klamath Falls offices of the Mid-Pacific Region of the U.S. Bureau of Reclamation (“BOR”) between BOR representatives and the Chairman of the Board of the Klamath Irrigation District (“KID”) and their respective counsels. In attendance for the BOR were representatives Theresa Bradford and George Driscoll, with BOR counsels Steven Palmer and Mario Manzo in attendance by phone. In attendance for the KID were KID Board Chairman Brent Cheyne and KID counsel Nathan Reitmann, with counsel Lawrence Kogan in attendance by phone.

The purpose of the meeting was to discuss several issues concerning the financing of the C Flume Replacement Project that the BOR did not wish to discuss as part of the public meeting scheduled for later that day. The C Flume is an elevated 4,200-foot-long concrete section of the C Canal of the Klamath Project which provides irrigation service to approximately 22,000 acres of land within the Project. The BOR retains ownership of the C Flume while the KID has been transferred responsibility to operate and manage it pursuant to Reclamation Contract 14-06-200-3784, dated November 29, 1954.¹ The C Flume was originally constructed in 1909 as a wood structure, and was replaced in 1922 with precast concrete U-shaped sections using monolithic beams with simple push-together joints. The C Flume superstructure and precast substructure were placed on the original foundations.²

During 2013, the BOR had issued a “Category 1” recommendation identifying the C Flume structure as a nonrecurring “Extraordinary Maintenance” (“XM”) item requiring immediate replacement because it was “necessary to minimize the risk of imminent harm to public health or safety, or property.” The KID’s prior Board and management had initially challenged the BOR on this assessment and the need to replace the C Flume structure, but it eventually conceded, under BOR pressure, to secure an engineering firm to assess alternative repair and replacement options.

The first issue concerned the BOR’s expression of intent to pursue with BOR’s Denver office, on KID’s behalf, agency approval to provide up to 35 percent non-repayment financing for “Emergency Extraordinary Management” of the C Flume Replacement project, consistent with the BOR’s authority under Section 9603(c)(3) of the Omnibus Public Land Management Act of

¹ See United States Department of the Interior Bureau of Reclamation, *Klamath Project, Oregon-California – Amendatory Contract Between the United States of America and the Klamath Irrigation District*, Contract No. 14-06-200-3784 (Nov. 29, 1954) (see attached). See also United States Department of the Interior Bureau of Reclamation, *Klamath Project, Oregon-California, Amendatory Contract Between the United States of America and the Klamath Irrigation District*, Contract No. 14-06-200-3784 Amendatory (April 25, 1962) (see attached).

² See William Ganong, Esq., *C Flume Replacement Project, Klamath Irrigation District Project Description* (7/9/2015) (attached).

March 30, 2009 (Pub. L. 111-11, 123 Stat. 1348-1349, 43 U.S.C. §510b).³ Unfortunately, the BOR has since failed to enact binding regulations establishing standards to make the determination that would enable the BOR to implement this provision. All that the BOR has done, thus far, is to restate the provision in its nonbinding Manual on Standards and Directives.⁴

At the meeting, Ms. Bradford and Mr. Manzo indicated that due to the approaching election season, the agency's Denver office had lost a number of its staff members, had been suffering from political apathy, and that it and the White House Office of Management and Budget had been ultra-sensitive about disbursing significant taxpayer funds to third parties as would be required if 35 percent of \$7.45 million would be called for (\$2.6 million). As a result, it was unlikely that they would be unable to secure such funding before the next president's inauguration, and most likely, that such funding would not be secured until June 2017. In addition, when counsel Kogan had asked how many of these "Qualified EXM" non-repayment financing requests had been granted, these BOR representatives stated that they had not yet entered into a single such arrangement. Ms. Bradford stated that, while there had been three such requests made, only two of them had qualified as EXM work, and the other request had been denied. Similarly, when Ms. Bradford stated that she had made such a request on behalf of the KID this past January 2016, said request, as well, had been denied without explanation. She and Mr. Driscoll emphasized how it was important to go slow with the Denver office in order to avoid another "no" answer. Apparently, the BOR representatives either did not receive a denial to their application for EXM non-reimbursable financing from the Denver office and/or OMB, or do not wish to provide it to the KID, because such a denial would be deemed a "final agency action" under the federal Administrative Procedure Act which would be appealable both administratively and judicially. [*A discussion of the XM and/or EXM designation of the C Flume is contained in the notes accompanying the proposed financing Contract modifications*]. Although the prior KID Board and management were aware of the need and had agreed to replace the C Flume in 2014, it only had first applied with the BOR for non-repayment financing in January 2016.

The second issue concerned the percentage contribution of adverse third party impacts to the ordinary wear and tear of the aged C Flume structure, helping to cause its degradation. In particular, there was the potential, if not, likely contribution to the C Flume's deterioration, of the vibrations caused to the C Flume structure over the course of approximately 86 years by buffeted airwaves generated by the frequent passage of freight trains over the railroad bridge owned

³ See Pub. L. 111-11, 123 Stat. 1348-1349, 43 U.S.C. §510b, *Omnibus Public Land Management Act of 2009* (March 30, 2009), at § 9603(c)(3), available at: <https://www.gpo.gov/fdsys/pkg/PLAW-111publ11/pdf/PLAW-111publ11.pdf>.

⁴ See U.S. Department of Interior Bureau of Reclamation, *Reclamation Manual – Directives and Standards, Extended Repayment of Extraordinary Maintenance Costs*, PEC-05-03, (490) 04/17/2014, at Sections 6.B and 6.C, available at: <http://www.usbr.gov/recman/pec/pec05-03.pdf>. See also U.S. Department of Interior Bureau of Reclamation, *Bureau of Reclamation Asset Management Plan Fiscal Year 2011*, at p. 19, available at: <http://www.usbr.gov/assetmanagement/Asset%20Inventory/AssetManagementPlanFY2011FinalWithSignaturePageOnly.pdf> ("**Emergency Criteria** – Flow or water surface elevation restrictions have been implemented as a result of deficiencies identified in the facility inspection resulting in the need for this major nonrecurring maintenance activity. Section 9603(c)(3) of Pub. L. 111-11 provides that if Reclamation determines that the facility in question has been maintained in accordance with the guidelines and criteria that Reclamation is directed to develop in Section 9602, then 35 percent of the funds advanced to a transferred works operating entity to perform the emergency XOM will be non-reimbursable. Applicability of this provision will be based on the following project inspection and maintenance criteria: All Category 1 recommendations related to the requested XOM work have been corrected within 6 months of identification; and All Category 2 recommendations related to the requested XOM work have been corrected within 1 year of identification and prior to the next reporting period.").

and/or operated by Burlington Northern Santa Fe, which is located merely 16"-18" above the top of the C Flume walls. Other not insignificant vibrations were transferred by the partially crumbling vertical concrete columns supporting the railway tracks and bridge into the underlying soil adjacent to and beneath the elevated C Flume structure. An additional adverse third party contribution to the degradation of the C Flume structure was potentially, if not, likely attributable to various tractor trailer truck and equipment truck collisions with the bridge structure spanning Oregon Highway 39 over which a portion of the C Flume passes, which left concrete gaps, scrapes and gouges, and exposed and twisted steel girders along the bridge sides and bottom. These third party contributions to the C Flume's degradation were enabled by the 1930 BOR agreement with Great Northern Railway Company (predecessor to BNSF) permitting the railroad's crossing of the Klamath Project facilities in Klamath County,⁵ and by the 1940 easement BOR had granted to the Oregon Department of Transportation to construct a highway (what became OR 39) over Reclamation lands.⁶ Photos of each such structure and the structural repairs KID had undertaken to strengthen and support the nearby C Flume structure in 2014 can be provided upon request.

On March 21, 2016, counsel Kogan had questioned by telephone Mr. Jeremy Morris of Adkins Engineering, the firm with which the KID had contracted in 2014, following an open bid process to undertake the C Flume Replacement Project, regarding whether they had examined the degree to which the frequent railroad freight trains' passage 16-18" over the C Flume and the frequent collisions with the OR 39 bridge crossing had contributed to the C Flume's degradation. Mr. Morris had responded that, since the prior KID Board and management had not raised this question Adkins had not looked into this. He subsequently responded by email that he did not believe following a brief verbal chat with fellow engineers after the phone call that there was much if any such contribution. Adkins, however, indicated that it had never placed monitors along the C Flume in these areas that would have permitted Adkins to render a scientific engineering assessment about this scenario. The BOR was not interested in pursuing this issue on behalf of the KID and indicated they would not assist in securing recovery of a portion of the financing costs from either BNSF or the State of Oregon.

A third issue that counsel Kogan had raised during the morning meeting concerned the BOR's failure to provide the KID with an accounting of its net Operations & Management ("O&M") expenditures for that portion of the Project for which it remains responsible under its 1954 contract with the BOR, as amended. Counsel Kogan and KID Board Chair Cheyne had previously raised this point during their March 21, 2016 meeting with Ms. Bradford and Mr. Driscoll at the BOR's Klamath Falls offices. Although Mr. Driscoll had subsequently dispatched spreadsheets to counsel Kogan reflecting O&M budgets for several years, these spreadsheets did not reflect any final certified accounting of KID debt or credits in connection with its O&M activities for any period of time. This point had been raised because KID members had not received an O&M accounting from the BOR for at least a decade, and were concerned about the level of indebtedness they had accumulated on their portion of the Project. This item was not discussed during the subsequent public meeting of March 24, 2016.

⁵ See United States Department of the Interior Bureau of Reclamation, *Klamath Irrigation Project – Contract for Railroad Crossings Over Government Irrigation Works* (I2r-2409) (June 24, 1930) (attached hereto).

⁶ See United States Department of the Interior Bureau of Reclamation, *Klamath Project – Grant of Easement to Construct and Maintain a Highway Over Land Withdrawn or Purchased Under the Act of Congress of June 17, 1902* (32 Sta. 388) (March 27, 1940) (attached hereto).

Given the BOR's inadequate response to his query, counsel Kogan subsequently searched for and discovered a 2014 report issued by the U.S. General Accounting Office at the request of Congressmen Peter DeFazio (D-OR 4th District) and Grace Napolitano (D-CA 32nd District) and Senators Edward Markey (D-MA) and Jared Huffman (D-CA 2nd District).⁷ This report revealed that the BOR had not provided an accounting of O&M expenses to the Klamath Irrigation Project since at least 2001. Counsel Kogan thereafter contacted the GAO to see if he could obtain any further information about GAO's findings re the Klamath Project. On March 25, 2016, Ms. Alyssa M. Hundrup, GAO Assistant Director returned counsel Kogan's phone call and indicated that GAO had decided not to include within its report any of the numbers the BOR had provided it concerning O&M because it did not pass their standards for accuracy and verification.

At 1:00 pm of the same day, a public meeting was convened between the KID's Board Chairman and BOR representatives, their respective counsels, and members of the public who are in favor of the KHSA, including former KID Board members and current district members. The purpose of the public meeting was to address the narrow agenda prepared by the BOR entitled, "Public Negotiation Session," which included only a discussion of the "Total Loan Amount (Article 4(a)), Repayment Term (Article 5(d) and (f)), and Emergency Reserve Fund Requirement (Article 16)."

The public meeting revealed the one-sidedness of the financing agreement the BOR now requires the KID to execute in order to avoid the BOR's withholding of water deliveries during the 2016 irrigation season.⁸ BOR representatives Theresa Bradford, George Driscoll, Steven Palmer, Esq. and Mario Manzo, Esq. were insistent that there be no changes to the BOR Financing Agreement (attached), except for the option of the BOR Contracting Officer, upon receiving the KID's request, to provide additional funds to complete the C Flume Replacement Project (See new Art. 4(a)).

Following the initial introduction of this provision by BOR counsels Palmer and Manzo, KID counsel Kogan suggested the insertion of another provision to reflect the BOR's good faith efforts to work toward securing up to 35 percent non-repayment financing, as had been discussed during the morning meeting. Before counsel Kogan could complete his sentence, Ms. Bradford raised her voice and spoke over Kogan and would not permit him to speak about this issue. As counsel Kogan raised his voice in an effort to continue speaking, Ms. Bradford continued to speak louder to drown out his voice. Counsel Kogan had demanded that counsels Palmer and Manzo control Ms. Bradford and had taken exception with Ms. Bradford's rude behavior, but the counsels refused to reign her in. Counsel Manzo responded by loudly asking counsel Kogan whether he wanted the finance negotiations to end and the deal taken off the table. Counsel Kogan asked counsel Manzo, in response, whether he was threatening him. Ms. Bradford then whispered a question to KID Chairman Cheyne – namely, whether he wanted to irrigate this season or not. She then proceeded to ask Mr. Cheyne how he would like to proceed and he responded "let's move forward."

⁷ See United State Government Accountability Office Report to Congressional Requesters, *Bureau of Reclamation: Availability of Information on Repayment of Water Project Construction Costs Could be Better Promoted* (GAO 14-764 (Sept. 2014), at cover page and pp. 12, 13-14, 38-39, 42-43, available at: <http://gao.gov/assets/670/665588.pdf>.

⁸ See United States Department of Interior Bureau of Reclamation, *Klamath Project, Oregon-California, Draft Contract Between the United States and the Klamath Irrigation District For Repayment of Extraordinary Maintenance Costs*, Contract No. 16-WC-20-4838 (see attached).

Counsel Kogan thereafter intervened only once by raising a question about Article 13(b) of the draft financing agreement. The first sentence of that article entitled, “General Obligation – Benefits Conditions Upon Payment,” permitted the United States to suspend water deliveries to the KID portion of the Project *immediately* upon the occurrence of a single incident of KID payment default.⁹ Counsel Kogan had been concerned that the first sentence of Article 13(b) did not enable the KID to cure a default (e.g., within a period of 12 months), and compared that sentence to the second sentence of Article 13(b). The second sentence prohibited the KID from delivering water to any district lands or irrigators that are in arrears for more than 12 months in making payments affecting the KID’s ability to repay its repayment obligation under this financing agreement.¹⁰ Although counsel Kogan pointed out that all commercial financing arrangements permit the borrower an opportunity to cure a default at least once without triggering the nonperformance of or the imposition of a penalty by the lender, counsel Manzo exclaimed that this was a government contract, that government contracts do not permit the curing of a default and that there was no negotiation on this point. Counsel Kogan has since discovered that counsel Manzo had not been honest in his response. Indeed, Article 20 of the 1954 contract between BOR and the KID, which is comparable to the second sentence of Article 13(b), effectively provides for such a cure. It states that,

“Refusal of Water to District in Case of Default

20. The United States reserves the right (in addition to the rights elsewhere herein reserved to the United States) to refuse to deliver water to the District in the event of the default of the District *for a period of more than twelve (12) months in any payment due the United States under this contract*” (emphasis added).

A member of the public responded to counsel Kogan’s concerns by saying that the Board and district had always accepted the lack of a default provision in their agreement.

Following Mr. Manzo’s response to counsel Kogan’s question, the BOR proceeded to complete the review of the financing agreement and adjourn the meeting. However, just prior to adjournment, Ms. Bradford pressed KID Chairman Cheyne to convene a special Board meeting to conduct a KID vote on (presumably in favor of) the agreement as early as Monday, March 29, 2016. She also asked whether he would mind if the BOR arranged for the press to report how the parties had reached a tentative agreement. Mr. Cheyne responded that he would try to do so. Although he did not agree to any such press announcement, an article appeared the next day (on March 26, 2016) in the Herald and News entitled, *Flume Replacement Contract Near Completion*.¹¹

⁹ See *Id.*, at Art. 13(b) (“The payment of charges becoming due pursuant to this contract is a condition precedent to receiving benefits under this contract. The United States shall not make water available to the District through Project facilities during any period in which the District is in arrears to the United States for any payment due under the terms of this Contract.”).

¹⁰ *Id.* (“The District shall not deliver water under the terms and conditions of this Contract for lands or parties that are in arrears more than 12 months in the payment of charges required for the District to repay its repayment obligation.”)

¹¹ See Lacey Jarrell, *Flume Replacement Contract Near Completion*, Herald and News (March 26, 2016), available at: http://www.heraldandnews.com/news/local_news/flume-replacement-contact-near-completion/article_208f9869-5a82-5bbc-b4a4-37e43c47a235.html.

A number of conclusions may be drawn from the information set forth above, a careful review of the terms and conditions of the proposed BOR financing Contract, and the proceedings of the recent private and public meetings:

1. Article 35 of the KID's 1954 contract with the BOR provides it with the option (right) of terminating the contract and repaying all of its capital and O&M obligations, thereby allowing it to acquire its portion of the District irrigation infrastructure (the transferred works), subject to ongoing annual charges for its respective share of Project costs for Reserved Works and for water usage in J Canal;¹²
2. The BOR's failure to provide the KID with an O&M accounting since 2001 keeps the KID Board and district members in the dark about the status of their accumulated net O&M expenditures, unable to fully pay off their Project obligations with certitude, and consequently, unable to exercise its right to terminate the contract and purchase the Project transferred works from the BOR;
3. The BOR is pushing the KID to immediately sign an extremely one-sided inflexible financing contract to replace the C Flume by March 31, 2016, even though the proposed BOR financing Contract, as-is, does not designate the replacement of the C Flume as an "emergency extraordinary management" ("EXM") eligible for up to 35% non-repayment (non-reimbursable) financing. The contract's treatment of the C Flume replacement merely as an "extraordinary management" item would cause the KID to accumulate up to an additional \$10 million of indebtedness. The proposed BOR financing Contract does not provide the KID with the opportunity to cure a default. This means that, if the KID fails, for whatever reason, to make a single payment or to perform a single transferred works repair precisely as scheduled, the BOR can suspend water deliveries and/or take back care, operation and maintenance of the transferred works;
4. The BOR is likely seeking retribution against the KID because of the KID's refusal to approve of the KBRA, the KHSA, the amended KHSA and the Upper Basin Agreement;
5. The BOR is working to marginalize the efforts of KID counsels Kogan and Reitmann to defend the KID's financial interests and right to acquire the transferred works;
6. The KID members must support the Board's efforts to take immediate measures to protect the District's financial interests and right to acquire the transferred works.

¹² See Contract No. 14-06-200-3784 (Nov. 29, 1954), *supra* at Art. 35 ("35.(a) All obligations of the District to make payments to the United States under Article 16 hereof, except those required by subdivisions (iii) and (vii) of Article 16(a), shall terminate *whenever all of the following have taken place*: (i) The United States has relinquished its title to the transferred works. (ii) The District has notified the United States that it no longer has any foreseeable need for technical or administrative services from the United States, of the types mentioned in subdivision (ii) of Article 16 hereof. (iii) *All amounts of money owed by the District to the United States under provisions of this and other contracts have been paid in full*") (emphasis added). See *Id.*, at Article 16(a)(iii) (providing that the annual estimated costs properly chargeable to the District for a calendar year include, "[a]n equitable portion of the estimated annual cost of operating and maintaining the reserved works, except for the charges provided in subdivision (vii) hereof, as determined by the Secretary. The estimate for these costs shall show the basis on which the total costs for operating and maintaining the reserved works are allocated between the District and other agencies."). See also *Id.*, at Article 16(a)(vii) (providing that the annual estimated costs properly chargeable to the District for a calendar year include "[e]stimated water rental charges or estimated costs of operation and maintenance for lands within the District supplied with water from the 'J' Canal, in accordance with the provisions of Article 14 hereof.")