

# Memorandum

Date: March 31, 2016  
From: Lawrence Kogan, Esq.  
To: Klamath Irrigation District Board of Directors and Members  
Re: **Notes Explaining Proposed BOR Financing Contract Modifications**

## 1. Emergency Extraordinary Maintenance Eligible for Non-Reimbursable Financing

The BOR has never classified the C Flume as requiring “emergency extraordinary maintenance” (EXM), despite its issuance, following a 2013 special inspection, of a “Category 1 recommendation” “requiring KID to perform engineering analysis and complete permanent repairs and/or a replacement to the structure.”<sup>1</sup> The BOR Manual on Directives and Standards defines “Category 1 recommendations” as “[r]ecommendations involving the correction of severe deficiencies where immediate and responsive action is required to ensure structural safety, operational integrity of a facility, or operating personnel/public safety.”<sup>2</sup>

BOR representatives, Bradford, Driscoll, Palmer and Manzo have insisted that it is absolutely necessary for the KID to sign the proposed BOR financing contract by no later than March 31, 2016, to ensure that construction of the C Flume replacement commences in early July 2016. The text of the proposed BOR financing contract, however, fails to designate the C Flume replacement work as an “emergency extraordinary maintenance” (EXM) item that must be immediately undertaken to prevent imminent risk to public health and safety; rather, it refers to the C Flume replacement as merely an “extraordinary maintenance” item. Article 1(c) of the proposed BOR financing contract defines XM as “major nonrecurring maintenance on the C Flume that is intended to ensure the continued safe, dependable, reliable delivery of authorized benefits of the Klamath Project.” Unlike in the special inspection report referenced in the BOR environmental assessment (“EA”) and finding of no significant impact (“FONSI”), there is NO mention of an imminent threat to public health or safety.

This difference in designation is significant because only EXM items are eligible under Reclamation law for up to 35% non-repayment (non-reimbursable) financing. XM items are not eligible for such favorable treatment.

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<sup>1</sup> See United States Department of the Interior Bureau of Reclamation, *Environmental Assessment C Canal Flume Replacement Klamath County, Oregon 2015-EA-008* (Dec. 2015), at p. 7, available at: [http://www.usbr.gov/mp/nepa/documentShow.cfm?Doc\\_ID=24026](http://www.usbr.gov/mp/nepa/documentShow.cfm?Doc_ID=24026). See also United States Department of the Interior Bureau of Reclamation, *Finding of No Significant Impact C - Canal Flume Replacement Klamath County, Oregon 2015-EA-008* (Dec. 2015), at pp. 2-3, available at: [http://www.usbr.gov/mp/nepa/documentShow.cfm?Doc\\_ID=23998](http://www.usbr.gov/mp/nepa/documentShow.cfm?Doc_ID=23998).

<sup>2</sup> See United States Department of the Interior Bureau of Reclamation, *Review of Operation and Maintenance (RO&M) Program Examination of Associated Facilities (Facilities Other Than High- and Significant-Hazard Dams)*, FAC 01-04 ((216) 05/04/2005) at p. 12, available at: <http://www.usbr.gov/recman/fac/fac01-04.pdf>.

If the C Flume replacement is an EXM item with a risk of “imminent” failure, there is no logical explanation why the BOR Denver office and the White House Office of Management and Budget would deny BOR Klamath Falls and Mid-Pacific office requests for non-reimbursable funding of the C Flume’s replacement well into 2017, as these representatives have claimed. On the other hand, if the C Flume replacement work is merely a Category 1 XM item, there is no real urgency for the KID to *replace* it now and incur up to \$10 million in new indebtedness subject to strict onerous conditions, and immediate less costly repairs should be adequate to ensure C Flume integrity and safe operation during the entire 2016 irrigation season. The extra time would afford the KID the opportunity to secure favorable alternative financing that would benefit District irrigators.

Consequently, unless the BOR designates the C Flume replacement as an EXM item that engenders an imminent risk of harm to public health or safety, these BOR representatives are unjustified in threatening to deny water deliveries to the KID during the 2016 irrigation season should it not sign the financing Contract *as-is* by March 31, 2016.

We have inserted new language in the proposed BOR financing Contract’s title and in several of its articles to reflect the EXM status of the C Flume replacement work to be performed. For example, we have added new paragraph (d) to Article 1 to define the term “EXM.” We also have added to Article 4 new paragraph (e). It ensures that the BOR Klamath Falls office undertakes good faith efforts to secure possible non-repayment (non-reimbursable) funding from the Denver BOR office and OMB following execution of the Contract for up to 35% of the amount BOR ultimately finances (\$7.45 million or a greater amount up to \$10 million) for the performance of such work. It also ensures the subsequent amendment of the financing Contract to reflect any such change. In addition, we have added language to Article 5 to ensure the KID is financially responsible only for the *reimbursable* portion of the financed amount.

2. Preserving the KID’s Ability to Cure a Payment or Performance Default, Consistent With the 1954 Contract’s Terms, to Prevent BOR Suspension of Water Delivery

The second paragraph of the preamble to the proposed BOR financing Contract acknowledges the BOR-KID Contract No. 14-06-200-3784, dated November 29, 1954. Article 1(b) of the proposed BOR financing Contract refers to the 1954 KID-BOR Contract as the “Existing Contract” (which we refer to as the “1954 Contract”), “as amended and supplemented, between the United States and the District.”

Article 6 of the proposed BOR financing Contract entitled “Limitations” states that, “*Except as specifically provided herein*, the Existing Contract shall continue in full force and effect as originally written and executed” (emphasis added). This means that the KID’s acceptance of the terms of BOR financing Contract as-is will effectively change the meaning of the terms of the existing (1954) Contract to the detriment of the KID and its members.

The second sentence of Article 13(b) of the proposed BOR financing Contract provides that, “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” (emphasis added).

BOR Representative Manzo was emphatic during the March 24, 2016 public meeting about how BOR government financing contracts unlike commercial financing contracts do not provide borrowers with the right to cure a default. This statement is patently untrue given the terminology of Article 20 of the existing (1954) Contract.

Article 13(b) of the proposed BOR financing Contract, as-is, is inconsistent with and undermines the KID’s rights under Article 20 of the existing (1954) Contract. Article 20 of the existing (1954) Contract provides that, “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).

Thus, to ensure that the KID does not sacrifice its existing right under Article 20 of the existing (1954) Contract to cure a payment default, we have modified the language of Article 13(b) of the proposed BOR financing Contract so that it is consistent with the existing (1954) Contract. This will prevent the BOR from suspending water deliveries to the KID in the event of a payment default persisting for fewer than 12 months. In other words, should the KID, for whatever reason, fail to make a payment on time, the BOR will be unable to suspend water delivery, as long as the KID makes payment before 12 months from the payment due date.

This recommended change to Article 13(b) of the proposed BOR financing Contract is all the more important in light of the language of Article 14(f) of said Contract, which is inconsistent with, and undermines Article 21(a) of the existing (1954) Contract.

Article 14(f) of the proposed BOR financing Contract, as-is, would be inconsistent with and undermines the KID’s rights under Article 21(a) of the existing (1954) Contract. It would permit the BOR to “take over from the District the care, operations and maintenance of the transferred works” if “the District is found to be failing any financial commitments or other commitments to the United States under the terms and conditions of this Contract...” Article 14(f) of the proposed BOR financing Contract provides that,

“In the event the District is found to be operating the transferred works or any part thereof in violation of this contract or the District is found to be failing any financial commitments or other commitments to the United States under the terms and conditions of this Contract, then upon the election of the Contracting Officer, the United States may take over from the District the care, operation, and maintenance of the transferred works by giving written notice to the District of such election and the effective date thereof.”

By comparison, Article 21(a) of the existing (1954) Contract provides,

“In event of default by the District *for a period of one (1) year on any payment* to the United States provided by this contract, or failure of the District to perform necessary repairs *for a period of one year* as provided in Article 7, or of any other violation by the District of the terms of this contract, the United States may, at the option of the Secretary, resume operation and maintenance of the transferred works, or any part thereof [...]” (emphasis added).

Thus, to ensure that the KID does not sacrifice its existing right under Article 21(a) of the existing (1954) Contract to cure a payment or performance default, we have modified the language of Article 14(f) of the proposed BOR financing Contract so that it is consistent with the existing (1954) Contract. This will prevent the BOR from taking over the care, operation, and maintenance of the transferred works in the event of a payment or performance default persisting for fewer than 12 months. In other words, should the KID, for whatever reason, fail to make a payment or necessary repairs to the transferred works on time, the BOR will be unable to take back the transferred works from the KID, as long as the KID makes payment or performs the repairs before 12 months from the scheduled due date.

3. Providing the KID With an Annual Accounting of its Portion of the Project Operations & Maintenance Indebtedness to Enable the KID to Better Assess its Option to Terminate the 1954 Contract and Purchase the Transferred Works

The KID’s existing (1954) Contract is only one of two Klamath Irrigation Project contracts providing an irrigation district with the right of purchasing the transferred works. Neither the KID nor the Tulee Lake Irrigation District (“TID”), the only other district in the Project with such a right, has received from the BOR a Statement of Project Construction Cost and Repayment (SPCCR) setting forth each district’s respective accumulated repayment obligation for their share of the Project.

Reclamation law and BOR’s Manual on Standards and Directives require that such statements shall *inter alia* include data on the total construction costs for the Klamath Project; the construction costs allocated to each project purpose, including irrigation; repayment information for costs allocated to each project purpose, including the amount irrigation districts have repaid as of the end of the fiscal year; and any financial assistance granted to irrigation districts. The statements also shall clearly identify whether Klamath Project costs are reimbursable or non-reimbursable. They also shall clearly allocate said costs among the respective irrigation districts.

The KID and its Board are currently unable to evaluate whether it is in the best interests of all district members to terminate the existing (1954) contract and to purchase the transferred works which the KID, on behalf of its district members, would exclusively own, operate and manage, unless the BOR is obligated to provide and the KID actually

receives these SPCCRs. A 2014 federal General Accountability Office report reveals that the BOR has failed to fulfill its legal obligation under the Reclamation law to provide the 22 Klamath Irrigation Project districts with SPCCRs since, at least, 2001, approximately the same time that the BOR had suspended water deliveries to the Project, resulting in the event known as “The Klamath Bucket Brigade.”<sup>3</sup>

We have added new Article 29 to, and also changed the corresponding section title/heading of the applicable section of, the proposed BOR financing Contract to ensure that the BOR complies with its Reclamation law obligation to provide the KID with annual SPCCRs during the entire duration of the Contract.

4. The Parties Should be Able to Modify the Contract by Subsequent Agreement

The proposed BOR financing Contract, as-is, does not permit the parties, at a later time, to agree to modify the Contract to accommodate changed or unforeseen circumstances. One example of a possible changed circumstance that could significantly benefit the KID is BOR’s ability during the Contract term to secure of up to 35% non-repayment (non-reimbursable) financing for the EXM C Flume replacement work. For this reason, we have added new Article 33 to enable the parties to amend the Contract to accommodate this KID benefit.

5. The BOR Financing Contract, As-Is, Was Drafted Exclusively by Reclamation and Should be Reflected as Such

Unless any one or more of these requested changes to the BOR’s proposed financing Contract are accepted, it is unconscionable for the BOR to require inclusion of language indicating that *no party* drafted the Contract language. Consequently, we have modified the language in the second sentence of redesignated Article 34 to factually and legally show that the United States shall be considered to have drafted the stated articles. The original language of redesignated Article 32 is acceptable only if the changes we have made to the Contract are accepted.

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<sup>3</sup> See Klamath Bucket Brigade, *A History of The Klamath Bucket Brigade* (May 7, 2001), available at: [http://klamathbucketbrigade.org/a\\_history\\_of\\_KBB.htm](http://klamathbucketbrigade.org/a_history_of_KBB.htm).