



Department of Water Resources

The Unexpected Complexity of the California WaterFix Project Has Resulted in Significant Cost Increases and Delays

Report 2016-132

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October 5, 2017

2016-132

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor presents this audit report concerning the Department of Water Resources' (DWR) management of the planning efforts for the California WaterFix Project (WaterFix). WaterFix is intended to address environmental and water supply reliability issues related to pumping water from the Sacramento-San Joaquin Delta (the Delta). Planning began in 2006 on the development of the Bay Delta Conservation Plan (BDCP), which consisted of several measures or activities for restoring the Delta and improving water reliability. Subsequently, in 2008 DWR initiated the Delta Habitat Conservation and Conveyance Program (conservation and conveyance program) to evaluate how to implement the BDCP and alternatives to it, including evaluating the environmental impacts and completing preliminary engineering work. Through the evaluation effort, DWR identified one of the alternatives—WaterFix—as its preferred approach. This report concludes that the planning phase experienced significant cost increases and schedule delays because of the scale and unexpected complexity of the project. For example, costs of the conservation and conveyance program's efforts to evaluate and plan for the potential implementation of the BDCP and its alternatives, which eventually included WaterFix, increased significantly. As of June 2017, the planning costs had reached \$280 million.

We also found that DWR did not follow state law when it replaced the program manager for the conservation and conveyance program. Specifically, DWR selected the Hallmark Group (Hallmark) to provide program management services without advertising a request for qualifications, and DWR could not demonstrate that it ever evaluated Hallmark's qualifications for this role. The cost of DWR's current contract with Hallmark has tripled from \$4.1 million to \$13.8 million.

Additionally, DWR has not completed either an economic or financial analysis to demonstrate the financial viability of WaterFix. Finally, it has not fully implemented a governance structure for the design and construction phase, and has not maintained important program management documents for WaterFix.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Selected Abbreviations Used in This Report

A&E	architectural and engineering
BDCP	Bay Delta Conservation Plan
DWR	Department of Water Resources
EIR	environmental impact report
EIS	environmental impact statement
NEPA	National Environmental Policy Act
URS	URS Corporation

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SUMMARY

The California WaterFix Project (WaterFix) is intended to address environmental and water supply reliability issues related to pumping water from the Sacramento-San Joaquin Delta (the Delta). The Department of Water Resources (DWR) began collaborating with state and federal entities as well as local water agencies (water contractors) in 2006 to develop an approach to restoring the Delta and improving water reliability, referred to as the Bay Delta Conservation Plan (BDCP). In conjunction with developing the BDCP, DWR also initiated the Delta Habitat Conservation and Conveyance Program (conservation and conveyance program) to evaluate how to implement the BDCP, which included considering alternatives to the BDCP, performing preliminary design, and assessing environmental impacts. Through this evaluation, DWR identified one of the alternatives—referred to as WaterFix—as its preferred approach. WaterFix focuses on the construction of a new water conveyance facility to improve water reliability and separates the large-scale Delta restoration effort originally included in the BDCP into a separate program called California EcoRestore. Water contractors of the State Water Project and the Central Valley Project, and the U.S. Bureau of Reclamation have primarily funded the project planning efforts that began with the BDCP and that have now shifted to WaterFix. This audit report concludes the following:

Because of the unexpected complexity of the project, the planning phase has experienced significant cost increases and schedule delays.

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The cost and timeline for preparing the BDCP increased because of the scale and unanticipated complexity of the project. In addition, costs of the conservation and conveyance program's efforts to evaluate and plan for the potential implementation of the BDCP and its alternatives, which eventually included WaterFix, also significantly increased. As of the end of June 2017, planning phase costs had reached approximately \$280 million.

DWR did not select appropriately its current program manager for the conservation and conveyance program.

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DWR did not follow state law when it replaced the program manager for the conservation and conveyance program. Additionally, DWR did not accurately value its initial contract with the new program manager—the Hallmark Group (Hallmark)—or ensure that it received fair and reasonable pricing for one of Hallmark's subcontractors.

DWR needs to take certain steps to better prepare for the transition of WaterFix to the design and construction phase.

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DWR has not completed either an economic or a financial analysis to demonstrate the financial viability of WaterFix. Furthermore, DWR has not fully implemented a governance structure for the design and construction phase of WaterFix. Moreover, DWR has not maintained important program management documents for WaterFix.

Other Areas We Reviewed

To address the audit objectives approved by the Joint Legislative Audit Committee, we also reviewed whether the State allocated any money from its General Fund to pay for the planning and design costs of WaterFix. We reviewed budget acts from 2006 through 2016 and found that the State did not allocate any General Fund money for the planning and design of the project. We also analyzed DWR accounting data, reviewed its 2008 management plan for the project, and interviewed relevant staff, and found that DWR did not use any General Fund money to fund the planning and design for the project.

Summary of Recommendations

Legislature

To improve management of large and complex infrastructure projects, the Legislature should enact legislation requiring agencies to publicly report significant changes in the cost or schedule of such projects if they are expected to exceed their established budgets by 10 percent or schedules by 12 months.

DWR

To better manage large infrastructure projects, DWR should develop and implement a project-reporting policy requiring its management staff to document and justify decisions to proceed with such projects if they are expected to exceed their established budgets by 10 percent or schedules by 12 months. DWR should make these documented decisions and justifications publicly available and submit them to the California Natural Resources Agency for review and approval.

To fully comply with state contracting law, DWR should ensure that it competitively selects architectural and engineering consultants based on demonstrated competence and professional qualifications. In addition, DWR should document in the contract file its evaluation of the competence and professional qualifications of all contractors and any subcontractors that are added to the contract subsequent to the competitive selection process. Further, DWR should ensure that it retains adequate documentation in its contract files to support that contract prices are fair and reasonable.

To ensure that DWR manages WaterFix in an effective manner, DWR should complete both the economic analysis and financial analysis for WaterFix and make them publicly available as soon as possible.

To prepare for the potential approval of WaterFix and to ensure that the project is managed properly during the design and construction phase, DWR should do the following:

- Develop an appropriate governance structure so that it is prepared to oversee the design and construction of WaterFix in the event it is ultimately approved.
- Develop and update when necessary the associated program management plan for the design and construction phase of the project.

Agency Comments

DWR generally agrees with our findings and recommendations, although it disagrees with our conclusion that DWR did not follow state law in selecting the program manager. DWR also did not agree with our recommendation that it develop and implement a project reporting policy.

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INTRODUCTION

Background

The Department of Water Resources (DWR) and other entities are developing the California WaterFix Project (WaterFix) in response to concerns about the impact of exporting water through pumps in the southern part of the Sacramento-San Joaquin Delta (the Delta). The pumping causes *reverse flows* in that it essentially pulls water upstream, adversely affecting endangered fish species by pulling them toward the pumps. To reduce these adverse effects, regulators have reduced water exports, which has in turn created a negative economic impact on communities and farms that depend on water from the Delta. The water from the Delta is mainly transported by two systems of water infrastructure: the State Water Project and the Central Valley Project. DWR is responsible for the construction, maintenance, and operation of State Water Project facilities while the U.S. Bureau of Reclamation (Reclamation) is generally responsible for Central Valley Project facilities. Local water agencies (water contractors) contract for water deliveries from these two systems. Figure 1 on the following pages presents the locations of certain State Water Project and Central Valley Project facilities, and of their respective water contractors that have participated in funding the planning phase that has culminated in WaterFix.

Development of the Bay Delta Conservation Plan

Planning efforts to address these environmental and economic concerns about the Delta began in 2006. We refer to all of the planning efforts from 2006 to the present as the *planning phase*. This phase would eventually include two overlapping efforts: development of the Bay Delta Conservation Plan (BDCP) and evaluation of how to implement it and other alternatives, including the environmental impacts and preliminary engineering. This evaluation effort was called the Delta Habitat Conservation and Conveyance Program (conservation and conveyance program). Figure 2 on page 9 describes the two planning efforts and the participants. The BDCP consisted of several conservation measures or activities that were intended to accomplish two goals: helping conserve native fish and wildlife species in the Delta and improving water reliability and quality. The BDCP was also expected to reduce future risks to water supplies conveyed through the Delta from earthquakes, levee failure, and climate change. The first conservation measure was the construction of a new conveyance (or water transportation) facility with new intakes on the Sacramento River in the north Delta to reduce the use of the pumps in the south Delta so as to minimize the reverse flows.

Figure 1
 Water Contractors That Contributed to the Conservation and Conveyance Program and Their Key Facilities





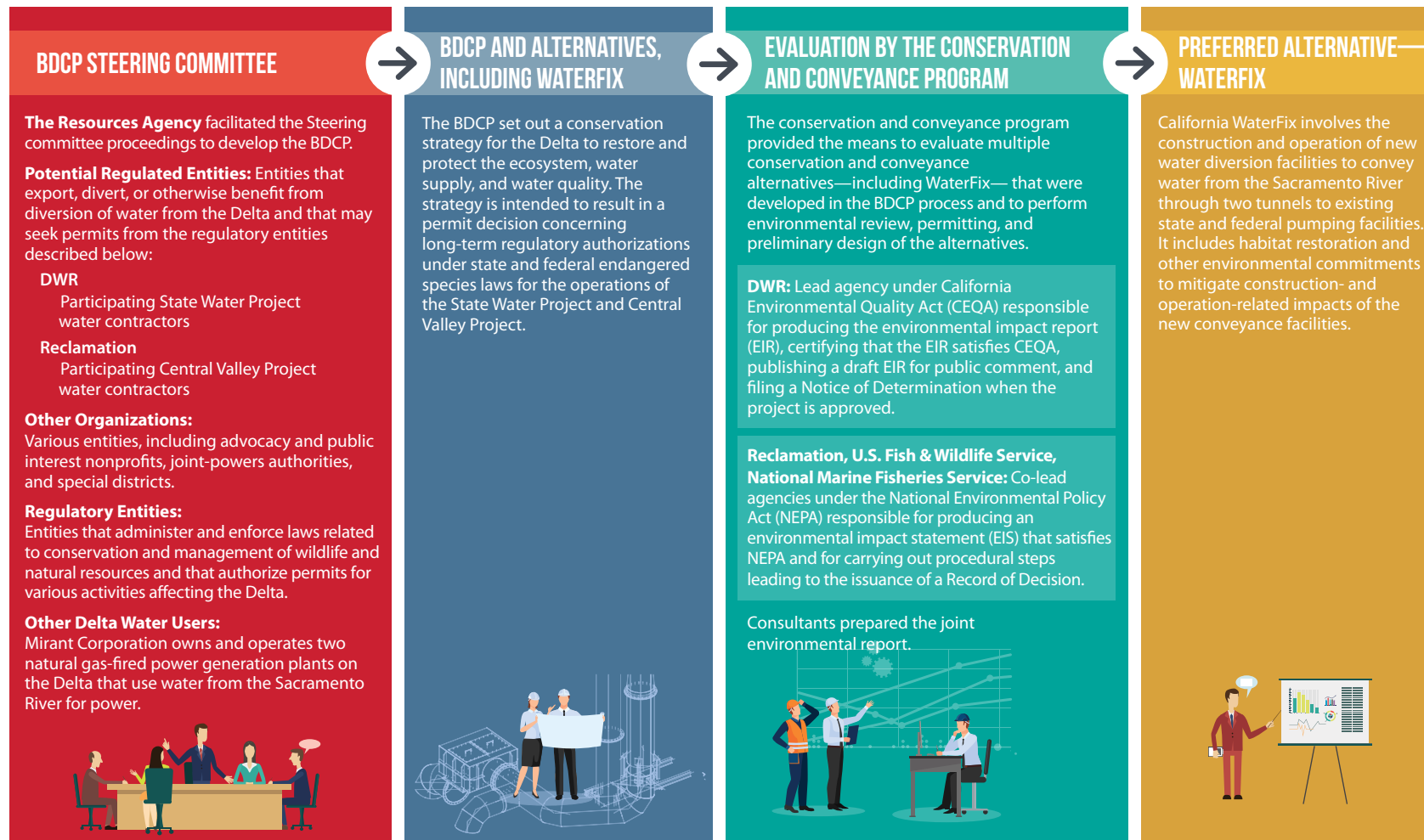
Sources: California State Auditor's analysis of DWR and Reclamation documents.
 * Santa Clara Valley Water District contracts with both the State Water Project and Central Valley Project.

The BDCP was intended to be the basis for obtaining 50-year permits under the federal Endangered Species Act and California Endangered Species Act that would create a stable regulatory framework for operations of the State Water Project and Central Valley Project. Specifically, the permits would provide long-term assurance that regulators would not require additional commitments of or place additional restrictions on the use of land, water, or other natural resources, nor would they require financial compensation—without the consent of the parties to the BDCP—as long as the BDCP was being implemented appropriately. The permits would also allow state and federal entities to engage in the activities included in the BDCP, which fell into the following categories:

- New water facilities construction, operation, and maintenance.
- Operation and maintenance of State Water Project facilities.
- Nonproject diversions of water.
- Habitat restoration, enhancement, and management.
- Monitoring activities.
- Research.

Multiple entities have voluntarily participated in the planning phase. These parties entered into a planning agreement that defined goals and objectives for the planning phase. The planning agreement also established a steering committee as the principal forum for discussing policy and strategy issues pertaining to the BDCP. The California Natural Resources Agency (Resources Agency) facilitated the steering committee and Figure 2 shows the other entities that constituted the committee. The steering committee, through a finance subcommittee, also developed the funding structure and budget for developing the BDCP.

Figure 2
WaterFix Planning Efforts and Participants



Sources: 2009 BDCP Planning Agreement, Conservation and Conveyance Program Memorandum of Agreement (MOA), Amended MOA, and www.californiawaterfix.com.

Transition From the BDCP to a New Approach Called *WaterFix*

The next planning effort began in 2008 when the Governor directed the Resources Agency to expedite completion of the BDCP and directed DWR to proceed with the environmental analysis of four Delta conveyance alternatives. To provide the means for evaluating and planning for the possible construction and implementation of these alternative conveyance facilities and habitat restoration projects, DWR initiated the conservation and conveyance program. This program was responsible for evaluating the BDCP and many other alternatives, which eventually included *WaterFix*. The conservation and conveyance program was composed of a team responsible for the following activities:

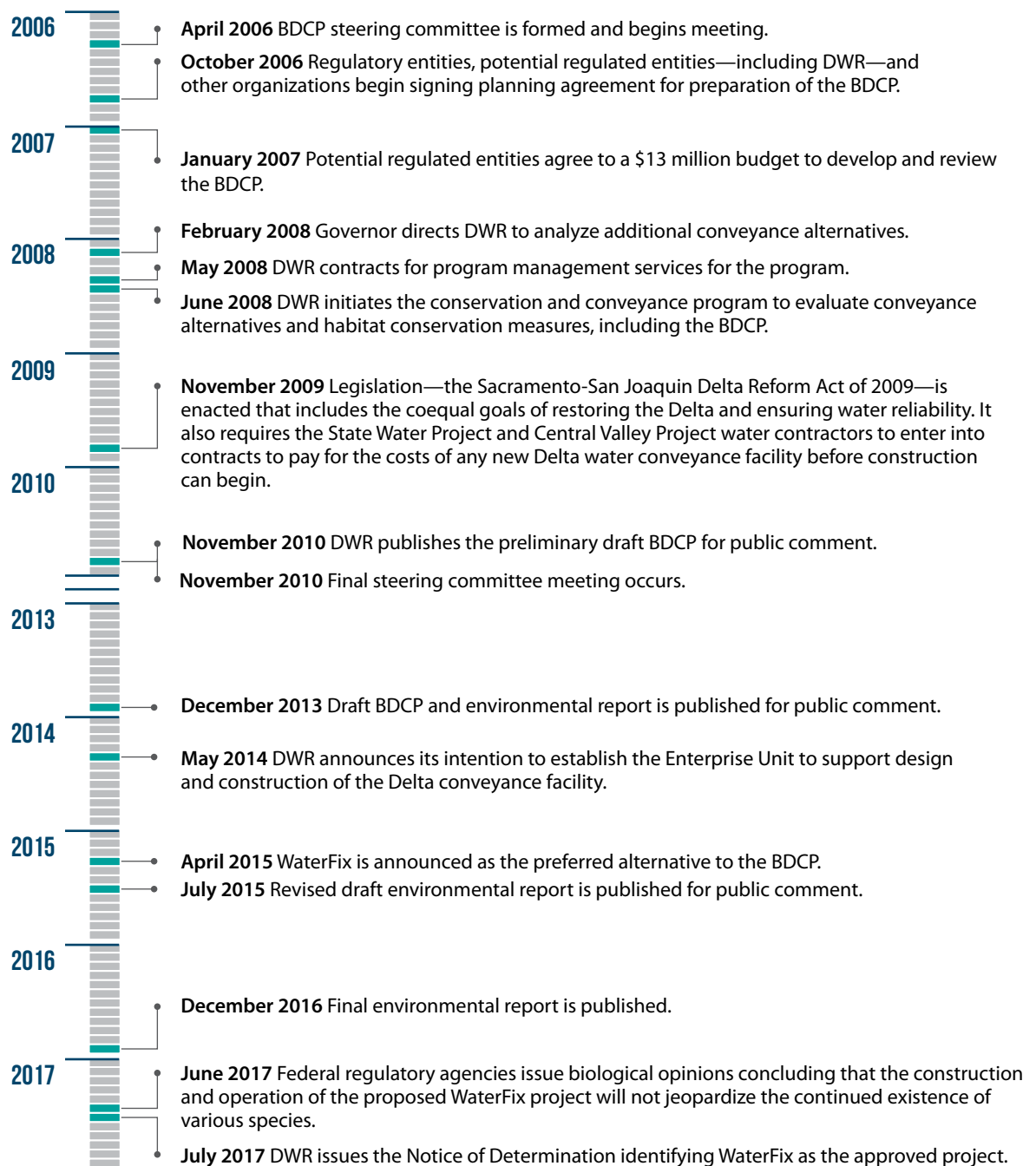
- Examining conveyance alternatives.
- Performing cost analyses.
- Formulating schedules.
- Selecting preferred alternatives.
- Obtaining the required environmental permitting and documentation.
- Obtaining property rights.
- Completing preliminary design.
- Completing final design and construction.

DWR initially contracted with an engineering firm to provide program management services and engineering support services for the conservation and conveyance program. Figure 3 shows a timeline of the key developments in the planning phase.

However, DWR and Reclamation revised their approach to improving reliability of water deliveries and protecting the Delta based on comments they received from the public and regulatory agencies during the environmental review process. In December 2013, DWR and Reclamation published a draft environmental impact document for the BDCP. The California Environmental Quality Act requires lead agencies to create an EIR to provide public disclosure of the environmental impacts of a proposed project. The report must identify all significant environmental effects, the mitigation measures proposed to minimize those effects, and alternatives to the project. The NEPA has similar requirements for an EIS. As the lead agencies, DWR, Reclamation, U.S. Fish & Wildlife Service, and the National Marine

Fisheries Service developed the joint environmental impact report/ environmental impact statement (environmental report) presenting the environmental impacts of the BDCP and alternatives to it.

Figure 3
Timeline of Key Developments in the BDCP and WaterFix Planning Process



Sources: DWR planning documents, state law, Governor's letter to the Senate in February 2008.

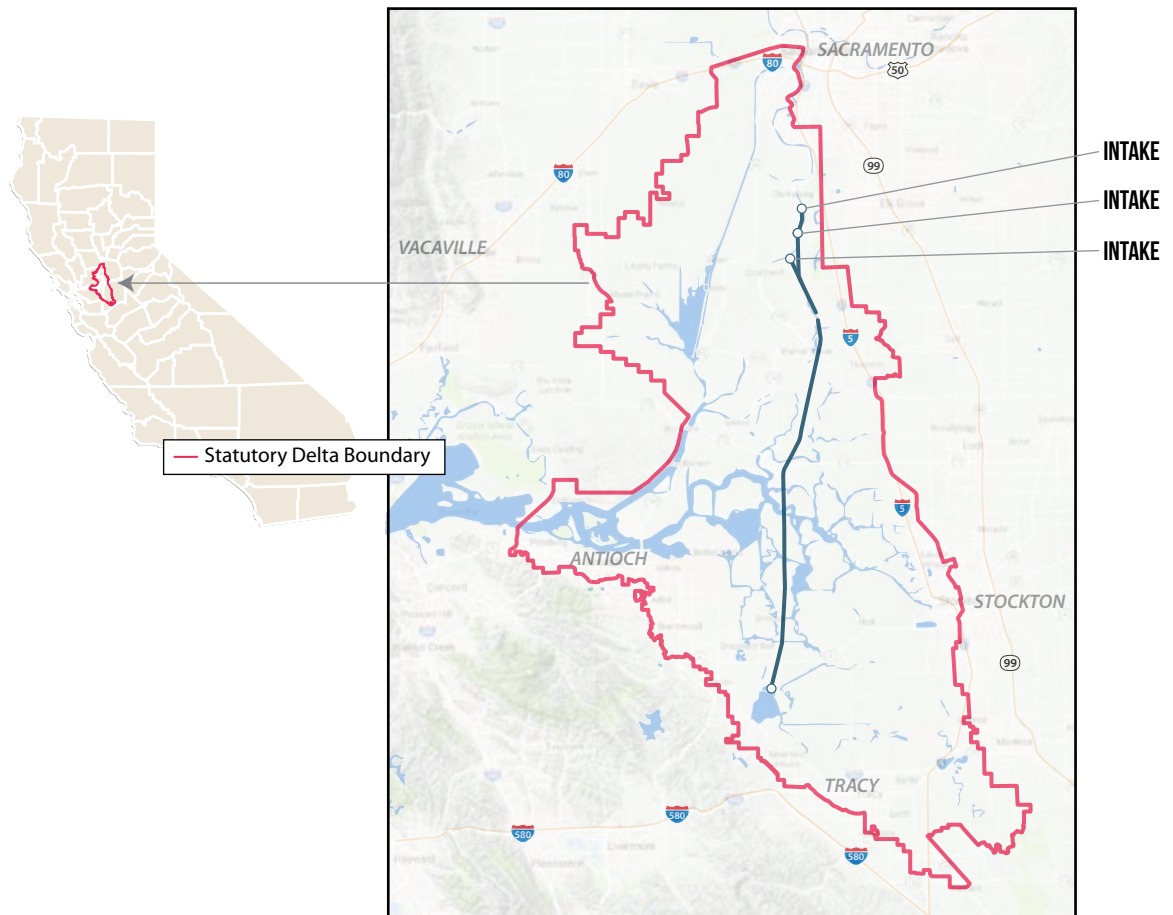
Following its publication of the draft environmental report in December 2013, DWR reported receiving numerous comments. These comments suggested that because of the uncertainty of the effects of climate change and the long-term effectiveness of habitat restoration in recovering fish populations, DWR should pursue a shorter permit term than the 50-year term the BDCP sought. Other comments suggested that the proposed conveyance facilities should be separated from the habitat restoration components of the BDCP. To address these concerns, DWR and Reclamation subsequently analyzed additional alternatives that would seek shorter-term permits and include only limited amounts of habitat restoration. They identified one of these alternatives, WaterFix, as the preferred alternative to the BDCP. WaterFix essentially separates the water conveyance effort from the large-scale Delta conservation effort.

As shown in Figure 4, WaterFix consists of three new intakes north of the Delta and other water conveyance facilities to address the reverse flow problem. However, WaterFix limits habitat restoration only to mitigating the construction-and operations-related impacts of the new facilities. A separate program, California EcoRestore, would provide restoration efforts for species conservation independent of the facility upgrades. Unlike the BDCP, WaterFix does not seek a permit like the 50-year permit discussed previously, and it does not provide the assurance that regulators will not restrict water and land use.

To give the public an opportunity to comment on the additional alternatives, DWR and Reclamation published in July 2015 a revised draft environmental report that presents WaterFix as the preferred alternative. Again, the public provided numerous comments. In December 2016, DWR and Reclamation published the final environmental report, which incorporates changes from the additional public comments. DWR initially estimated that in spring 2017, Reclamation would issue its *Record of Decision* stating which alternative it had chosen to pursue, the alternatives it had considered, and whether all practicable means to avoid or minimize environmental harm had been adopted. However, Reclamation has not issued the Record of Decision. The director of DWR nevertheless stated that in the meantime DWR will continue moving forward with WaterFix planning efforts, including permitting and regulatory efforts. On July 21, 2017, DWR issued a Notice of Determination that identified WaterFix as the approved project and indicated that the project will have a significant effect on the environment, an EIR was prepared, and a mitigation monitoring plan was adopted. In addition to these approvals, several regulatory and permitting processes are ongoing and must be completed before construction of WaterFix can move forward, including hearings by the State Water Resources Control Board

regarding water rights and water quality that are expected to last until sometime in 2018. We refer to the overall activities that span the BDCP and WaterFix as the *project*.

Figure 4
WaterFix Proposed Project Location



Source: DWR's final EIR, figures 1-1, 3-9, and 3-10.

Funding for the Planning Phase Has Come From a Number of Sources

Generally, the State Water Project's water contractors pay the costs for its construction, replacement, and maintenance and operations. However, because the planning phase for the BDCP and WaterFix has been a voluntary collaboration among several state and federal entities to improve water supply reliability and to restore ecosystem health in the Delta, Reclamation and some Central Valley Project water contractors also contributed funding. As we stated in the Summary, DWR did not use any General Fund money to fund

the planning of the project. DWR did not fully track the various contributions made toward the costs of preparing the BDCP, as we explain more fully later. These costs consisted of two categories—the costs attributable to fishery agencies¹ for their work related to the development and review of the BDCP, and other costs related to preparing the BDCP, including contracted consultant costs. The \$6 million cost for the first category was split evenly between DWR and Reclamation over two years. For the second category, three entities agreed to share the consultant costs and other related costs: DWR; San Luis & Delta Mendota Water Authority (the Authority)—a joint-powers authority that represents certain Central Valley Project water contractors; and Mirant—a corporation that owns and operates power generation plants on the Delta.² The costs for the second category have reached approximately \$54 million. Although documentation is limited, DWR explained that it included charges for its share of the BDCP costs in the State Water Project water contractors' annual statements. The Authority collected funds for its portion of the costs from its member agencies.

Participating State Water Project and Central Valley Project water contractors agreed to share the planning costs for the conservation and conveyance program equally between the two groups. DWR established a specific account to track these contributions. As noted previously, participation in the funding was voluntary, and any participating water contractor could withdraw upon 30-days notice; however, doing so would require the remaining participating water contractors to make up for the lost contributions. Figure 5 shows the amounts and proportional share each entity contributed. Figure 5 also shows that Reclamation, Metropolitan Water District of Southern California (Metropolitan), the Authority, and Kern County Water Agency (Kern) together contributed roughly 82 percent of the total planning funds through June 2017.

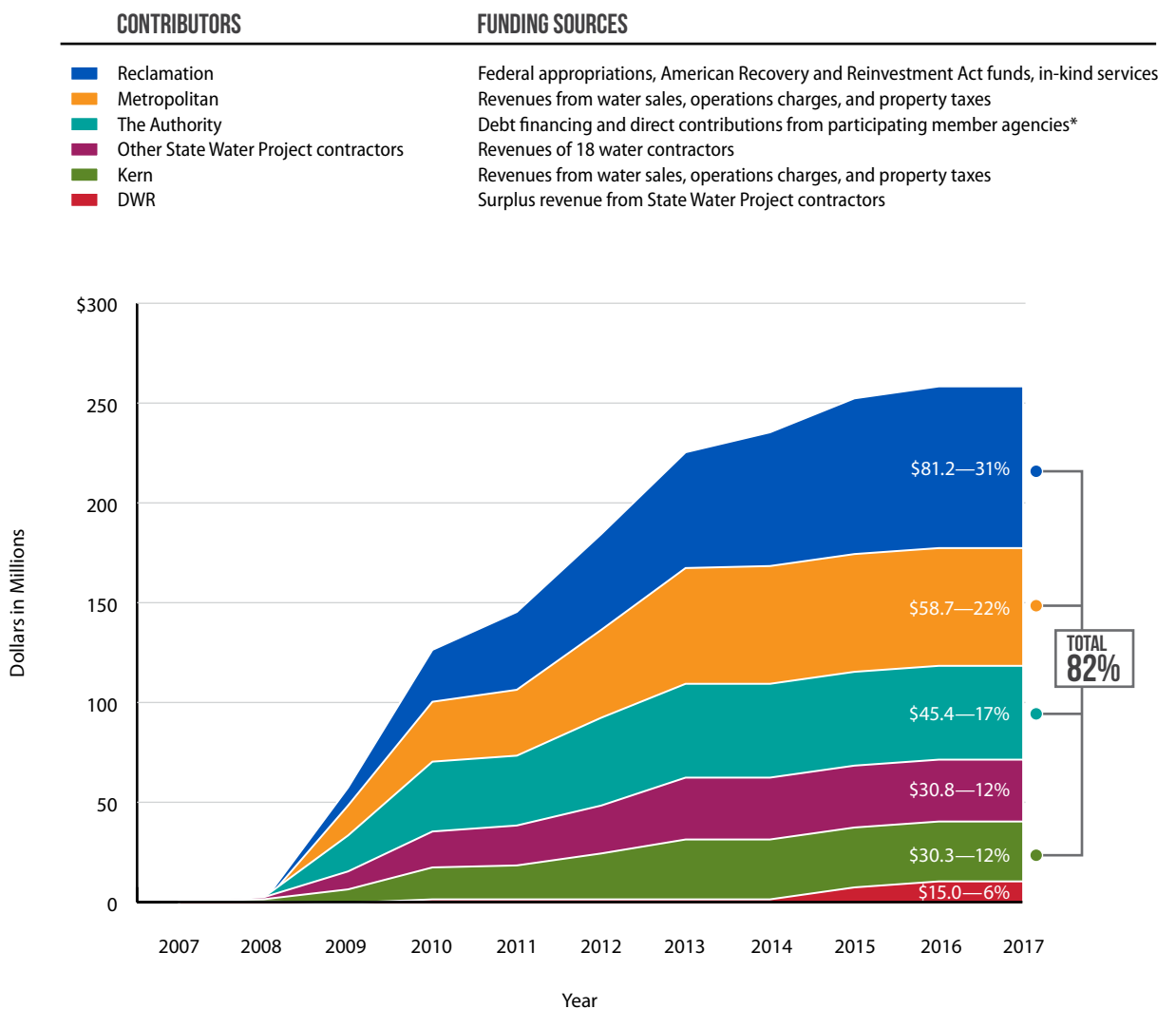
To collect the State Water Project share, DWR entered individual funding agreements with the 20 State Water Project contractors that decided to participate. Contributions were proportionate to each participating contractor's water allocation from the State Water Project. For example, Metropolitan and Kern receive the two largest allocations of water from the State Water Project; therefore, they contributed the largest portions of the State Water

¹ *Fishery agencies* refers to the California Department of Fish and Game, the U.S. Fish & Wildlife Service, and the National Marine Fisheries Service.

² Initially in January 2007, Mirant Corporation agreed to contribute 10 percent of the approved consultant costs and DWR and the Authority agreed to split the remainder equally. Two years later, the parties agreed to cap Mirant Corporation's contributions at the lesser of 10 percent or \$300,000 per 12-month period.

Project’s share of costs. Their contributions generally came from their revenues, which are largely composed of proceeds from water sales, user charges, and property taxes.

Figure 5
Four Entities Contributed Most of the Funding for the Conservation and Conveyance Program
 January 2008 Through June 2017



Source: California State Auditor’s analysis of DWR accounting data.

* The Authority contributed a total of \$47.1 million in funds from debt financing and direct contributions from participating member agencies toward the planning phase, \$2.1 million of which was used to meet its BDCP funding obligations. In June 2017, it contributed another approximately \$400,000.

The Authority and Reclamation contributed the Central Valley Project share of costs for the conservation and conveyance program. The Authority contributed \$45.4 million and used debt financing for 95 percent of its contribution, with the principal and interest required to be paid from water system revenues generated by 17 Central Valley Project water contractors that decided to participate.³ The remaining 5 percent, or roughly \$2.3 million, was contributed directly by another five water contractors. Reclamation contributed \$81.2 million in federal funds and in-kind services, such as program management, legal services, and preliminary engineering.

³ Westlands Water District agreed to pay 100 percent of the principal and interest on the debt. The Authority reimburses Westlands Water District for a portion of such debt service payments from amounts the Authority receives from the 16 other participating Central Valley Project water contractors.

Because of the Unexpected Complexity of the Project, the Planning Phase Has Experienced Significant Cost Increases and Schedule Delays

Key Points

- The costs and timeline for preparing the BDCP increased because of the scale and unexpected complexity of the project.
- The costs to evaluate and plan for the potential implementation of the BDCP and its alternatives, which eventually included WaterFix, also increased.

The Costs and the Timeline for Preparing the BDCP Increased Because of the Unexpected Complexity of the Project

In a June 2006 steering committee meeting, the finance subcommittee presented a \$13 million budget for preparation of the BDCP, which included budgeted consultant costs for completing all tasks except public outreach. The budget consisted of \$6 million to provide for the participation of fishery agencies and \$7 million for consultant costs and other costs related to the BDCP. As stated in the Introduction, fishery agency costs were to be split evenly between DWR and Reclamation and the consultant and other costs were to be split among DWR, the Authority, and Mirant Corporation. Following the establishment of the budget, DWR entered into a \$1.6 million contract with Alameda County Flood Control and Water Conservation District Zone 7 (Zone 7) to cover its share of consultant costs for December 2006 through June 2008. The contract states that Zone 7 possessed special expertise related to the unique environmental compliance process that would guide the BDCP process. The scope of work in the contract included engaging the services of a BDCP consultant, the preparation of the BDCP, and the services of Zone 7 to manage the contract with the BDCP consultant. However, the parties subsequently discovered that the \$1.6 million budgeted over the 19-month term of the contract was insufficient to allow the consultant to successfully complete the BDCP. The parties first amended the contract in June 2008 to add an additional year, extending the term through June 30, 2009. In the spring of 2009, the parties agreed to amend the contract a second time, increasing the contract by \$3.5 million and the term by another two years, thus extending the contract through June 30, 2011. The parties amended the contract a third time in March 2010 to increase the contract by another \$2.6 million. These three amendments collectively increased the cost of this contract from \$1.6 million to \$7.7 million, nearly five times the original amount, and they extended its term by three years. DWR's financial records indicate that it spent \$7.5 million on this contract, and according to the chief of its enterprise accounting branch, the funding for these payments came from State Water Project contractors. However, DWR did not fully track BDCP funding or spending. Documentation provided by the Authority indicates that it contributed \$5.2 million toward these costs, but we do not have any data on Mirant Corporation's share of BDCP costs.

According to contract documents justifying the amendments, the BDCP was being developed with a greater level of stakeholder involvement than was customary in most conservation plans; consequently, development of the plan was proving to be more complicated, time-consuming, and expensive than originally anticipated. For example, the justification included in DWR's second amendment to its contract with Zone 7 states that the BDCP process called for a more extensive independent science advisory effort—the process of including independent scientific input to assist with plan development—than is typically the case with conservation plans, and this effort increased the cost of preparing the conservation strategy beyond the original estimate.

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Development of the plan was proving to be more complicated, time-consuming, and expensive than originally anticipated.

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The science advisors for the project also recommended expanding the scope of the plan to include a larger share of terrestrial species and habitat, and this recommendation further increased projected costs. The cost increase contained in the third contract amendment was primarily due to the decision to have the BDCP consultant take on portions of the EIR that were not originally included in the scope of work. Specifically, according to the contract documents justifying this amendment, the parties decided that part of the environmental impact evaluation could be conducted most efficiently by the same consultants that were preparing the BDCP.

The organizational and decision-making structure of the BDCP effort presented another challenge to the timely and efficient completion of the plan. In particular, the documented justifications for the second and third contract amendments explained that the time and cost of preparing the BDCP increased substantially because the BDCP consultant, while designing the plan, engaged directly with the steering committee, which consisted of several dozen members representing state and federal water and resource agencies, water contractors, and other organizations—a unique departure from the customary process in which a consultant team primarily develops the conservation plan elements that are then endorsed by a single advisory committee. For example, according to the justification for the second amendment, the consultant spent a significant amount of time and resources developing a report that evaluated conservation strategy options, but it subsequently

received requests from members of the steering committee that required the consultant to develop and model various operational scenarios repeatedly, and these efforts were costly and time-consuming. However, the justification for the contract amendment also defended the time-consuming stakeholder process, stating that it would help ensure the plan's stability and likelihood of implementation. Nevertheless, the project's costs increased significantly.

Although Zone 7 stopped managing the BDCP consultant in July 2010, costs for preparing the BDCP continued to increase when DWR entered into a direct contract with the consultant to continue preparing the BDCP. This new contract ultimately increased the BDCP costs by \$41.4 million. Specifically, in June 2010, DWR and the consultant signed a two-year, \$11 million contract for tasks such as completing working drafts of the BDCP chapters, obtaining public feedback on the BDCP, and finalizing the BDCP. By the time DWR and Reclamation released the draft BDCP for public review and comment in December 2013, the contract had been amended several times increasing the maximum amount payable under the contract by a total of \$20 million, in part because of unanticipated modifications to the project that resulted in the need for multiple revisions to the plan. After publishing the draft BDCP in December 2013, DWR further amended the contract three more times, increasing the contract amount by an additional \$10.4 million.

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The cost of preparing the BDCP rose to approximately \$60 million.

.....

These amendments cited the need for additional time and funds because of changes in the public draft of the BDCP resulting from a new permitting approach; the addition of three new alternatives to be analyzed, reviewed, and incorporated into the BDCP; and an extended public comment period. Notwithstanding, we estimate that the cost of preparing the BDCP rose to approximately \$60 million.

Costs to Evaluate and Plan for the Potential Implementation of the BDCP and Other Alternatives Also Significantly Increased

DWR has so far spent roughly \$260 million to evaluate and plan for the possible construction of alternative conveyance facilities and habitat restoration projects, including those that constitute

the BDCP and, subsequently, WaterFix. In March 2009, DWR estimated the initial budget for these activities to be \$140 million, including the costs of management, planning, administration, preliminary engineering, and environmental services. The budget was to cover the conservation and conveyance program's evaluation and planning efforts starting in 2008 until its expected completion in 2010. Conservation and conveyance program funds were also used to pay for the \$41.4 million direct contract that DWR entered into with the BDCP consultant, as mentioned previously.

However, DWR subsequently reassessed the scope, technical needs, and schedule for the conservation and conveyance program's evaluation and planning efforts, which led to a substantial cost increase. Consequently, in October 2010, the steering committee discussed the need for an additional \$100 million—a 71 percent increase to the initial budget of \$140 million—to continue the planning process. In 2012 DWR signed agreements with water contractors for the supplemental funding of \$100 million to pay the “actual” remaining costs of the planning phase. These supplemental funding agreements extended the term of the planning process through December 2014. A document prepared by the former chief of DWR's division of engineering indicates that the \$100 million was intended to fund remaining environmental and engineering activities as well as a contingency reserve. With the \$100 million in supplemental funding, the total budget for the conservation and conveyance program's evaluation and planning efforts had increased to \$240 million.

DWR ultimately exhausted the \$240 million budget and contributed \$15 million in surplus revenue in 2015 and 2016 to fund additional planning costs. Reclamation and the Authority also together contributed an additional \$6.8 million. Through June 2017, total contributions exceeded the planning phase budget by more than \$21 million. Moreover, as of June 2017, DWR had spent 99 percent of the \$261 million contributed to fund the conservation and conveyance program. As described previously, although DWR officials filed the Notice of Determination in July 2017, Reclamation has not filed the Record of Decision. Nevertheless, DWR officials stated that no additional funds would be needed to complete the planning phase for WaterFix, as approved.

As discussed in the Introduction, DWR has entered into water supply contracts with State Water Project contractors. Pursuant to these contracts, DWR collects payments from the contractors to recover all water supply-related costs. DWR deposits this revenue in a special account. The text box shows the purposes for which this revenue can be used. According to DWR, surplus revenue is available to DWR to fund the acquisition and construction of the State Water Project, including WaterFix planning activities that are

a necessary precursor to construction. When we researched the \$15 million of surplus revenues that DWR used to fund project planning costs in 2015 and 2016, we discovered that the account in which DWR collects the revenues had an available cash balance that had grown from \$10.7 million in December 2013 to \$286 million by the end of April 2017. Furthermore, DWR projects the balance will increase to \$293 million by the end of December 2017. According to DWRs' chief of the State Water Project Analysis Office, a major factor contributing to the increase in the balance of this fund has been the decrease in outstanding debt resulting from the repayment of a California Water Fund loan and general obligation bonds initially used to finance the State Water Project. He further stated that DWR holds monthly meetings with the state water contractors, at their request, to provide transparency of State Water Project activities and financial information regarding State Water Project costs and revenues, including the surplus revenue balance. We reviewed the agenda and minutes for the June 2017 meeting and found that DWR disclosed the \$286 million surplus to the state water contractors. Finally, the chief stated that these funds are available to pay for new State Water Project facilities, including WaterFix. However, DWR has not developed any concrete plans for how it will use this growing surplus revenue balance.

Purposes and Priorities for Using State Water Project Revenue as Described in State Law

All revenues the State derives from the State Water Resources Development System (also known as the State Water Project)—including those from the sale, delivery, or use of water or power—shall be used annually only for the following purposes and in the following order:

1. The payment of the reasonable costs of annual maintenance and operation of the State Water Resources Development System and the replacement of any of its parts.
2. The annual payment of the principal and interest on the bonds issued in accordance with the Water Code.
3. Reimbursement to the California Water Fund for funds used for State Water Resources Development System construction.*
4. Any surplus revenues in each year not required for the purposes specified in this chapter of the law shall be appropriated to the department for acquisition and construction of the State Water Resources Development System.

Source: Water Code, Section 12937 (b).

* Priority 3 is no longer active because DWR has reimbursed all funds it used from the California Water Fund.

Recommendations

Legislature

To improve management of large and complex infrastructure projects, the Legislature should enact legislation requiring agencies to publicly report significant changes in the cost or schedule of such projects if they are expected to exceed their established budgets by 10 percent or schedules by 12 months.

DWR

To better manage large infrastructure projects, DWR should develop and implement a project-reporting policy requiring its management staff to document and justify decisions to proceed with such projects if they are expected to exceed their established

budgets by 10 percent or schedules by 12 months. DWR should make these documented decisions and justifications publicly available and submit them to the Resources Agency for review and approval.

To ensure it makes appropriate use of its growing surplus revenue balance, DWR should develop a detailed plan describing how it intends to use these funds.

DWR Did Not Select Appropriately Its Current Program Manager for the Conservation and Conveyance Program

Key Points

- DWR did not follow state law when it replaced the program manager for the conservation and conveyance program.
- DWR did not accurately value its initial contract with the new program manager—the Hallmark Group (Hallmark)—or ensure that it received fair and reasonable pricing for one of Hallmark’s subcontractors.

DWR Did Not Follow Proper Procedures in Replacing the Program Manager for the Conservation and Conveyance Program

Although DWR initially used a robust selection process that was in line with both the letter and spirit of state contracting law to select its first program manager, it later used other methods to select a replacement program manager, and these methods did not follow the competitive process required under the law. State law requires state agencies that are contracting for architectural and engineering services to select contractors based on demonstrated competence and professional qualifications. The architectural and engineering (A&E) contract process seeks the most highly qualified contractor; the agency then negotiates with that contractor a price that is fair and reasonable although not necessarily the lowest price. Additionally, based on the services DWR identified in the Scope of Work section of its request for qualifications and its contract with URS Corporation (URS)—its original choice to provide program management services—DWR was contracting for specific services that are consistent with *construction project management*, which a licensed engineer or general contractor must perform, as state law requires.

In May 2008, DWR used a competitive process to engage a consultant to provide program management services and engineering support services, as required by state contracting law and its own regulations. DWR followed the process detailed in the text box to select URS as the most qualified firm to support the

DWR’s Process for Selecting Its Initial Program Manager

- Developed a request for qualifications that established the criteria for selecting the program manager, including relevant education; possession of a valid California professional engineer license; experience in the planning, managing, and overseeing of large water resources infrastructure; strategic program development; project management; and experience in environmental compliance and engineering and construction.
- Published the request for qualifications in the State Contracts Registry and a relevant professional publication.
- Held a mandatory meeting attended by approximately 55 individuals representing numerous interested firms. The meeting included a detailed question-and-answer session to clarify requirements and expectations.
- Received statements of qualifications from two interested firms.
- Interviewed the two responding firms.
- Used a defined scoring rubric to score the qualifications and interview responses of the two responding firms based on criteria defined in the request for qualifications.
- Negotiated with the highest-scoring firm for a cost that was deemed fair and reasonable.
- Awarded the contract to the most highly qualified responding firm.

Sources: DWR’s request for qualifications and various other DWR documents.

conservation and conveyance program team's efforts. In its response to the request for qualifications, URS identified the individual who would serve as program manager and presented his qualifications, detailed in Table 1, as part of the larger competitive process. DWR then negotiated with URS for a contract worth up to \$60 million and with a term from May 2008 through December 2015.

Table 1
Hallmark's Program Manager Does Not Appear to Possess the Qualifications That DWR Required When It Selected URS

REQUIREMENTS AND SELECTION CRITERIA FROM DWR'S REQUEST FOR QUALIFICATIONS	URS - PROGRAM MANAGER	HALLMARK - PROGRAM MANAGER
Possession of a valid professional engineering license	Yes	No
Relevant education	M.S./B.S. Civil Engineering Rutgers University	B.S. Economics North Carolina State University
Demonstrated competence and relevant experience of the program manager in the planning of large water resources infrastructure projects	<ul style="list-style-type: none"> Project Director, MWD Isolated Facility, Metropolitan Water District of Southern California, Sacramento County, California Project Manager and Sponsor, Lake Perris Dam Seismic Evaluation and Dam Replacement Options, State of California Department of Water Resources, 2006 Senior Reviewer, Swift No. 2 Hydroelectric Project, Cowlitz County PUD, Cougar, Washington, 2006 	None included in information provided to DWR or on Hallmark's website.
Demonstrated competence and relevant experience of the firm in the planning of large water resources infrastructure projects, strategic program development, project management, environmental compliance, engineering, and construction	<p>Managed programs ranging from those costing hundreds of millions of dollars to those costing more than \$19 billion in construction value, including the following:</p> <ul style="list-style-type: none"> \$3.4 billion San Francisco Transbay Terminal Program \$5.5 billion California Prison Health Care Receivership Program <p>Developed and implemented public and stakeholder coordination strategies to address the outreach issues associated with these complex programs.</p>	<p>Managed construction for several projects including the following:</p> <ul style="list-style-type: none"> \$500 million UC Merced Campus \$33 million UC Davis MIND Institute \$120 million Bay Area Housing Project \$3.5 million Silicon Laboratories facility

Sources: DWR's request for qualifications (RFQ NO. 10023878), URS's statement of qualifications, Hallmark's website (<http://hgcpm.com/>), and contract documentation.

However, not long after awarding the contract, DWR directed URS to replace its program manager with the president of Hallmark without DWR's demonstrating that Hallmark was qualified to provide these services or had the required professional license. Specifically, 13 months after awarding the contract to URS, DWR issued a notice of disapproval that removed the individual URS had designated as the program manager apparently because he was not working full-time on the project. A clause in DWR's contract with URS allowed DWR to disapprove "the assignments or the continuing assignment of specific contractor personnel, subcontractors and subcontractor personnel." However, the contract did not indicate a specific process by which the disapproved personnel should be replaced. Because of the size, cost,

complexity, and significance to the State of WaterFix, we expected DWR to require URS to provide an equally qualified replacement; alternatively, DWR could have used a competitive process to select a replacement program manager based on the criteria it had established in the original request for qualifications. Instead, in an August 2009 amendment to its contract with URS, DWR replaced the program manager by directing URS to engage Hallmark as a subcontractor to provide the program management services.

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The contract did not indicate a specific process by which the disapproved personnel should be replaced.

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By directing URS to engage Hallmark as a subcontractor in this manner, DWR did not select a firm that met the requirements of the request for qualifications, DWR's regulations, or state law. Our review of the Hallmark contract file found no indication of how DWR identified Hallmark as the replacement program manager nor any evidence that DWR evaluated Hallmark's qualifications for this role. DWR asserted that Metropolitan recommended Hallmark based on Metropolitan's previous experience working with the firm. However, the general manager of Metropolitan told us that although he did recommend Hallmark, Metropolitan had not previously worked with the firm. Furthermore, when we asked him why he recommended Hallmark, he indicated that he was given the name by a third party but could not recall who that third party was. He also said that Metropolitan and other water contractors interviewed other individuals but determined Hallmark was the firm it would recommend to DWR; however, he was unable to provide us with any documentation of those interviews or how the water contractors arrived at their conclusion to recommend Hallmark. We were also unable to ascertain why Metropolitan was interviewing candidates on behalf of DWR.

DWR officials stated that DWR made its own independent assessment of Hallmark's qualifications, and it based its selection on Hallmark's successful program management experience in other programs. We subsequently talked to the former director of DWR who was involved in the selection of Hallmark. He recalled that Hallmark's efforts on the University of California, Merced campus project brought Hallmark to the attention of the water contractors because Hallmark was largely given credit for managing the engineering contractors on that project. He also indicated that he thought the initial recommendation for Hallmark came from the

general managers of Metropolitan and Westlands Water District. He stated that the water contractors believed that Hallmark could provide additional cost controls over the project. Nonetheless, DWR was unable to provide us with documentation of any assessments or with any other records supporting the selection of Hallmark.

Therefore, we performed a high-level comparison of the qualifications of Hallmark and URS and found that Hallmark does not appear to possess the technical credentials or experience on relevant projects that DWR required when it engaged URS. In the initial request for qualifications, DWR identified the following as necessary qualifications of the program manager:

- Relevant education.
- Possession of a valid professional engineering license.
- Experience in the planning, managing, and oversight of large water resources infrastructure.
- Experience in strategic program development.
- Experience in project management and environmental compliance.
- Experience in engineering and construction.

In selecting Hallmark, DWR disregarded many of the qualifications required for the original program manager. Table 1 on page 24 shows that Hallmark lacked a licensed engineer required by law for construction project managers and had no demonstrable experience planning large water resources infrastructure projects. Further, DWR was unable to provide some of the information listed in Table 1 regarding Hallmark's qualifications. Instead, we searched Hallmark's website and other public sources to obtain more information about the firm's qualifications.

DWR explained that after one year working with URS, it became clear that demonstrated program management skills were needed rather than a strict focus on engineering. Although DWR officials cited Hallmark's successful program management experience in other programs as a reason for the selection, staff members in its A&E contracting unit (contracting unit) raised concerns over Hallmark's apparent lack of qualifications.

Additionally, an employee at DWR with knowledge of the A&E contracting process also raised concerns over Hallmark's qualifications. The employee indicated that Hallmark's president,

who is the program manager, had no architecture, engineering, or environmental services experience—only a degree in economics—as the allegations in the text box indicates. DWR’s internal auditors conducted an investigation into these allegations and concluded that DWR entered into the contract with Hallmark without using a request for qualifications. However, the internal auditors also stated that determining whether DWR’s entering into that contract without such a request violated state contracting law was a legal question that the investigation could not answer. DWR’s legal counsel subsequently reviewed the issues and found that DWR’s approach was legal; however, DWR’s counsel based its opinion in part on an unsupported assertion that DWR had determined that Hallmark was qualified.

In directing URS to subcontract with Hallmark, DWR also failed to follow the selection process that state law and DWR’s own regulations require, potentially resulting in DWR not receiving the best value for the contracted services. Although DWR asserted that subcontracting the program management services was appropriate and legal, the relationship established between URS and Hallmark does not appear to be a contractor-subcontractor arrangement. In a traditional contractor-subcontractor relationship, we would expect to see several conditions, including the following: the contractor is responsible for the subcontractor’s work products, the contractor determines payment to the subcontractor, and the contractor is legally responsible for the work of the subcontractor. However, the provisions DWR added to the contract with URS in the amendment to bring Hallmark on as a subcontractor clearly demonstrate that URS was not overseeing Hallmark’s work products, it was not determining payment to Hallmark, and it was not legally responsible for Hallmark’s work. Specifically, the language in the contract amendment that added Hallmark stated the following:

- “Hallmark will be reporting directly to and receive direction from DWR.”
- “DWR shall make the sole and final determination as to the payment to Hallmark of any and all amounts invoiced by Hallmark.”

Excerpts From Allegations Against DWR About Selection of Hallmark as Program Manager

“The first activity that I believe violates the code and one that we routinely allow is letting contract managers direct contractors to add a specific sub to an existing contract. Put simply, the contract manager wants a specific contractor not currently under contract to perform some type of work allowed under the existing contract. Direct the prime to add the firm you want and have them do the work. No pesky RFQ, no SOQ review, no silly determining if the new folks are actually the most qualified, no allowing other firms to apply for the work, no following the code. The practice has become so prevalent, we’re actually starting to address it in our additional payment provisions where we allow a higher markup on subs we direct the contractor to add. This looks surprisingly like a bribe to keep them quiet.”

“Possibly the most egregious example of this [letting contract managers direct contractors to add a specific sub to an existing contract] is when a former DOE Division Chief, directed the Washington Division of URS (‘URS-WD’) to engage the president of Hallmark Group, Inc. (‘Hallmark’), to fill the position of Program Manager by subcontracting with Hallmark for this purpose” (46-8104, Amendment 1). Subsequently the PM services were removed entirely from the 8104 scope of work (Amendment 6) and Hallmark Group was issued its own contract (46-9986). No RFQ was issued; the new contract’s scope of work says simply that 8104 ‘was being administratively separated into two contracts.’ According to his LinkedIn profile, Hallmark Group, provides ‘[m]anagement of large capital programs on behalf of government and institutional entities.’ No architecture, no engineering, no environmental services. He has a degree in economics. The ‘E’ in A&E does not stand for economics. The new contract was later tripled in size.”

Source: DWR employee emails.

- “DWR shall provide written notice to URS of those portions of Hallmark’s invoice that are approved for payment.”
- “URS’s liability to DWR in any manner arising out of or in connection with any act, omission, negligence or any other aspect of [Hallmark’s program manager] or Hallmark’s performance that is the subject of the amendment shall be strictly limited to whatever damages or other relief URS actually obtains from [Hallmark’s program manager] or Hallmark.”

In summary, the process DWR used to award the “subcontract” without demonstrating that Hallmark had the required qualifications and professional license is contrary to the letter and spirit of the law, which is intended to create competition to ensure that the State obtains a competent and qualified contractor at a fair and reasonable price.

The ultimate result of this subcontract is that DWR later awarded Hallmark its own contract, also without a competitive process. Specifically, in 2013 DWR removed the program management services component from the URS contract and entered into a new direct contract with Hallmark through what DWR termed an *administrative separation*, known also as an *assignment*.⁴ The contract documentation justified DWR’s choice not to use a competitive process by referencing the fact that URS had been selected through a request for qualifications. However, this justification is inapplicable given that Hallmark was never identified nor included in URS’s response to the request for qualifications. DWR officials told us that Hallmark had been functioning as program manager for three years and thus had demonstrated its qualifications. Nevertheless, as shown in Table 1 on page 24, Hallmark did not have the necessary qualifications to fill the program manager role in the first place based on DWR’s original request for qualifications.

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**DWR later awarded Hallmark its own
contract, also without a competitive process.**

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We question DWR’s rationale for assigning the contract to Hallmark. When we asked DWR about the administrative separation and assignment of the program management services to Hallmark, DWR officials stated that it did so to increase workflow efficiencies. They also stated that its staff had experienced frustration going through URS to

⁴ *Assignment* is the legal term for transferring the rights and obligations of a contract from one entity to another.

work with Hallmark, because of the additional layer of administrative processes. They did not believe paying URS the 5 percent subcontractor markup for work Hallmark performed was cost-effective. According to DWR officials, the assignment provided its staff with direct access to the program manager while simultaneously saving the program significant costs. However, we question that reasoning because DWR created the difficulties in the first place by not awarding competitively a new contract for program management services, which would have provided its staff direct access to the selected program manager, following its notice of disapproval of URS's program manager in July 2009. In addition, we are not convinced that DWR is saving money through the assignment because Hallmark has had to subcontract many of the program management functions, and DWR is generally paying a markup of 5 percent for invoices to Hallmark for overseeing those subcontractors.

DWR Did Not Accurately Value Its Initial Contract With Hallmark or Ensure That It Received Fair and Reasonable Pricing for one of Hallmark's Subcontractors

DWR did not establish accurately the cost of the Hallmark contract before awarding it, resulting in an increase in the expense of the original contract award. When it awarded the contract to Hallmark, DWR did not ensure that the funding would cover adequately the services required for the duration of the contract; instead it simply transferred \$4.1 million from the original URS budget to the new Hallmark contract. Although DWR awarded the contract for \$4.1 million, it did not base this amount on accurate historical monthly costs or the correct term of the contract. Instead, DWR incorrectly used a contract term of 12 months to calculate the contract amount even though the contract itself was drafted for a term of 37 months. DWR also did not take into account the additional services that Hallmark's subcontractors were performing under the contract.

Hallmark has had to subcontract many of the program management functions and DWR is generally paying a markup of 5 percent.

Consequently, just seven months after awarding the contract, DWR amended it, increasing the budget by \$7.3 million to cover the contract's full term. DWR amended the contract three additional times to extend the term through December 2017 and to increase the total cost by \$2.4 million. As of July 2017, the amount of the Hallmark contract had increased to a total of \$13.8 million.

In addition, DWR paid for an important work product without ensuring that the price was fair and reasonable or that the work product was finalized. Specifically, in October 2012 DWR issued a deliverables paid task order to engage McKinsey & Company (McKinsey), a subcontractor to Hallmark, for \$2.69 million, to develop the governance structure for the design and construction phase of the project, but DWR did not justify adequately the cost or ensure that it received a final work product.⁵ DWR regulations require it to estimate the value of services to be provided based on fees paid for similar services or based on a market survey. However, DWR staff in the contracting unit raised concerns about whether the cost of this task order was fair and reasonable because Hallmark did not present price comparisons or market rates for similar work. Although the task order stated that the price negotiated for McKinsey was fair and reasonable, it provided no analysis or support for the price, and we do not believe it complied with DWR's regulations that require a fair and reasonable price be provided based on fees paid for similar services or on a market survey.

DWR's contracting unit staff stated that they did not feel an email from Hallmark was sufficient justification for a fair and reasonable price because Hallmark did not provide either comparable prices or a market survey. The DWR contracting staff also were concerned that Hallmark's email did not specify how Hallmark determined whether the price was reasonable because the email simply stated that the dollar amount "is worth it because McKinsey has such a great track record", without specifying the dollar amount. However, DWR could not provide any documentation showing that the contracting unit staff's concerns were ever addressed. Consequently, we don't believe that DWR had adequate assurance that Hallmark's price for this \$2.69 million deliverable was "fair and reasonable." Additionally, despite paying \$2.69 million for this task order, DWR never made sure the consultant finalized the governance structure documents. DWR stated within the task order that these documents were due in January 2013, and according to DWR officials, DWR received draft documents but did not receive final governance structure documents. We discuss the status of the governance structure in more detail later in the next section.

⁵ *Deliverables paid task orders* are task orders for which the contractor receives payment based on completion of the deliverable or work product. This differs from regular task orders for which the contractor is paid a specified rate for time spent on the task.

Recommendations

To fully comply with state contracting law, DWR should ensure that it competitively selects architectural and engineering consultants based on demonstrated competence and professional qualifications. In addition, DWR should document in the contract file its evaluation of the competence and professional qualifications of all contractors and any subcontractors that are added to the contract subsequent to the competitive selection process.

To ensure that only qualified subcontractors are added to contracts after the initial award is made, DWR should make sure that contractors select their own subcontractors and that DWR subsequently approves the selection after it verifies their qualifications.

DWR should ensure that it retains adequate documentation in its contract files to support that contract prices are fair and reasonable and all deliverables are received.

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DWR Needs to Take Certain Steps to Better Prepare for the Transition of WaterFix to the Design and Construction Phase

Key Points

- DWR has not completed either an economic or a financial analysis to demonstrate the financial viability of the project.
- DWR has not implemented a governance structure for the design and construction phase of WaterFix.
- DWR has not maintained important program management documents for WaterFix.

DWR Has Not Completed Needed Analyses That Would Demonstrate the Financial Viability of WaterFix

Despite DWR’s own policy stating that an economic analysis is a critical element of the planning process, DWR has not yet finalized one for WaterFix, although it released an incomplete draft economic analysis in 2016.

The text box defines the critical questions about the project that this analysis and a financial analysis are intended to answer. In October 2012, DWR issued a task order for a subcontractor, the Brattle Group, to perform an economic analysis that would measure the benefits and costs of the BDCP from a statewide perspective. Over the next 31 months, DWR budgeted \$434,000 for the economic analysis. According to the various task order amendments, development of this analysis was a lengthy process that included various scope changes and input from a variety of stakeholders including Reclamation, the fishery agencies, public water agencies, and Delta agricultural interests. In addition, the economic analysis was revised several times to address feedback from stakeholders, changes in the project’s costs and footprint, and revisions to the draft BDCP. Then in May 2015, DWR canceled the remaining work on the BDCP economic analysis because the project transitioned from the BDCP to WaterFix, as described in the Introduction.

Questions That Economic and Financial Analyses Answer	
ECONOMIC ANALYSIS	FINANCIAL ANALYSIS
Answers the questions:	Answers the questions:
Should the project be built at all?	Who benefits from the project?
Should it be built now?	Who will repay the costs?
Should it be built to a different configuration or size?	Can the beneficiaries meet repayment obligations?
Will it have a net positive social value for Californians regardless of who receives the benefits and who pays the costs?	Will the beneficiaries be better off financially after they meet repayment obligations?

Source: DWR’s *Economic Analysis Guidebook*.

In June 2015, DWR directed the Brottler Group to instead develop an economic analysis for WaterFix, for which it had allocated an additional \$356,000. DWR made public a November 2015 incomplete draft of the WaterFix economic analysis in response to a Public Records Act request in September 2016. However, DWR has not finalized the economic analysis report. According to DWR officials, the economic analysis could not be finalized because DWR determined it was not possible to complete an accurate cost-benefit analysis until understanding which agencies will be participating in and funding the project and at what level. DWR officials further stated that the project will have varying economic benefits for each of the funding agencies, based on their unique situation including access to alternative water supplies and type of water users. DWR officials stated that once individual water agencies define their level of participation through their various public board processes, DWR will incorporate that information into a final cost-benefit analysis.

DWR has not finalized the economic analysis report.

We believe that it is essential for DWR to complete the economic analysis report as soon as it determines the extent to which individual water agencies will participate in funding the design and construction of WaterFix.

DWR also has not completed a financial analysis for WaterFix. The financial analysis answers critical questions about the project, which the previous text box lists. In 2012 DWR contracted with the consulting firm Public Finance Management through Hallmark, and in 2013 DWR initiated a task order for Public Finance Management to support the completion of a financial analysis for the project. The scope of work in the task order was organized to generate key deliverables, with the general objectives of reaching agreement on fair and affordable cost allocations and establishing reliable financing for implementation of the project. The task order acknowledged that these deliverables would require the collective effort of DWR, Reclamation, and state and federal water contractors, with the consultant providing support. As of July 2017, DWR data show that it has paid Public Finance Management \$276,000 for its efforts.

However, according to DWR officials, no final decisions on cost allocations or interim financing have been made because discussions with state and federal water contractors are still ongoing. DWR officials further explained that the final financial analysis report

cannot be prepared until the contractors desiring to participate in WaterFix are identified. They also stated that DWR's contractor—Public Finance Management—modeled a wide range of financing options for WaterFix that were shared with water contractor boards. According to DWR officials, once individual agencies decide to participate, the financing will be tailored to meet each agency's needs.

The financial analysis is critical in determining whether water contractors are willing and able to pay for the construction of WaterFix. The Delta Reform Act of 2009 states that construction of a new Delta conveyance facility (such as WaterFix) shall not be initiated until the water contractors that contract to receive water from the State Water Project and Central Valley Project have made arrangements or entered into contracts to pay for two things: (1) the costs of the environmental review, planning, design, construction, and mitigation required for the construction, operation, and maintenance of any new Delta water conveyance facility and (2) the full mitigation of property tax or assessments levied for land used in the construction, location, mitigation, or operation of new Delta conveyance facilities. The financial analysis is intended to provide a business case that the project is beneficial, financial modeling to analyze the cost of the project and the debt service associated with financing the project, and an acceptable cost-allocation methodology.

DWR Has Not Fully Implemented a Governance Structure for Managing the Design and Construction Phase of WaterFix

Although DWR contracted with a consultant to develop a governance structure for the design and construction phase of the project, it has not fully implemented such a structure. Originally, in 2008, DWR intended the role of the program manager to include overseeing the entire project, from planning through construction. However, in the first nine months of 2012, DWR management, Hallmark, and the State Water Project water contractors attempted with limited success to create a new governance structure that would address issues of organizational design and governance, the roles and responsibilities of the stakeholders in the decision-making process, and guidance on project implementation. In an October 2012 task order, DWR stated that such a governance structure would be unique and immensely important. At the same time, DWR contracted with McKinsey to develop a governance structure that would create a new way for DWR to work with the public water agencies. DWR used McKinsey's draft work product as input for the development of the Design and Construction Enterprise Unit (Enterprise Unit), which DWR publicly announced as the governance structure for the project in 2014.

Program Management Documents

Program Management Plan

A dynamic document maintained by the program manager throughout the life of the program providing a scope of work, schedule, and cost estimates. It also includes the following:

- Staffing requirements.
- Funding sources.
- Reporting relationships.
- Participant roles and responsibilities.
- Monitoring, change control, and reporting policies and procedures.
- Critique of project successes and recommendations for improvements (upon completion of the project).

Funding Statement

Also called the *program component statement*, this is the authorizing document for funding a program and is the key monitoring and control document. It is a dynamic document maintained by the program manager throughout the life of the program. It includes the following:

- Specific funding sources for the estimated, budgeted, and proposed years.
- Explanation of any changes between the budgeted year and the proposed year.

Charter

Describes a proposed activity at a high level. It is the responsibility of the program manager to ensure that the charter is kept up to date during the life of the program. The Charter includes the following:

- Program objective.
- Scope.
- Critical success factors.
- Deliverables.
- Milestones.

Source: DWR's Water Resources Engineering Memorandum 65a.

In September 2015, DWR developed a draft agreement that would formally implement the Enterprise Unit as the governance structure for the design, construction, and implementation phase of WaterFix. The draft agreement envisioned that the water contractors would create a joint-powers authority—the Conveyance Project Coordination Agency (coordination agency)—to be a party to the agreement along with DWR. The contractors would organize the coordination agency to assist DWR in the design, construction, and implementation of WaterFix. The draft also envisioned that DWR and the coordination agency would enter into a contract with a “world-class project manager”—designated the *program director*—to head the Enterprise Unit.

However, according to DWR officials, it is currently in discussion with the public water agencies to create a governance structure, but whether it will be the same or similar to the Enterprise Unit is unclear. According to DWR officials, because WaterFix has not yet been approved and because the public water agencies have yet to form the coordination agency, the Enterprise Unit has yet to be officially implemented. DWR officials stated that it is currently in discussion with the public water agencies to determine, under current conditions, what the most effective governance structure will be for the design and construction phase. Further, these officials told us that the governance structure will very likely follow some of the recommendations from the McKinsey effort. It is essential that DWR develop an appropriate governance structure so that it is prepared to oversee the design and construction of WaterFix in the event that the project is ultimately approved.

DWR Did Not Properly Maintain Important Program Management Documentation

Although WaterFix has evolved since it began as the BDCP, DWR has not maintained required program management documents for the planning phase. DWR policy requires certain documentation to initiate and authorize a State Water Project-funded program—such as the DWR program that supports WaterFix—including a management plan, funding statement, and charter. The text box describes each of these documents. That policy also states that the program manager

should maintain this documentation throughout the life of the program, and DWR included that same requirement in its contracts with URS and Hallmark.

Initially, when DWR established the conservation and conveyance program, it followed its policy by creating the required management documents. Specifically, in 2008, DWR's division of engineering prepared a Charter and Management Plan (management plan) for the program, which contained all of the necessary management documents. Within the management plan, DWR identified and listed URS's program manager's responsibilities, including requesting program changes, reporting the status of business activities to DWR's executive manager and deputy directors, and updating the management plan as required.

The contract with the program manager also specified that the program manager was to develop and maintain the program management plan and further enumerated the following responsibilities: reporting on cost, schedule, significant milestones, and resources compared to established baselines as well as providing oversight, analysis, and quality control of other contractors. The management plan identified the chief of DWR's division of engineering as the executive manager of the conservation and conveyance program and the individual responsible for overseeing the program manager. The executive manager was also to oversee the program budget, schedule, engineering, and real estate activities and report to DWR's executive management with periodic updates.

However, roughly one year after DWR established the conservation and conveyance program, it began to experience significant personnel changes but did not ensure that the management plan was properly updated to reflect these changes. For example, as this report describes earlier, DWR replaced URS as the program manager with Hallmark in August 2009. Four years later in 2013, DWR's executive manager of the conservation and conveyance program retired. According to a former chief deputy director, DWR subsequently moved the responsibility for overseeing the program manager to DWR's executive management, although the management plan was never updated to reflect this change.

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Roughly one year after DWR established the conservation and conveyance program, it began to experience significant personnel changes.

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Furthermore, DWR's executive management also experienced significant turnover. For example, since DWR established the conservation and conveyance program in 2008, it has had three different directors and five different chief deputy directors. However, DWR did not update the management plan to document these changes or to describe how DWR handled them.

We reviewed the contents of the electronic document management system that DWR uses to store project management documents. The system is an electronic repository that contains numerous documents, including monthly progress reports that provide updates on the project's milestones and accomplishments, various meeting agendas and minutes, and monthly budget reports. However, through our review of the documents in this system we were only able to locate one update to the management plan that covers the planning phase. The updated program management plan was completed in November 2009, but it did not properly address the significant personnel changes or the shift in the project from the BDCP to WaterFix. If WaterFix is ultimately approved, it will be important for DWR to develop, and update when necessary, a management plan for the design and construction phase of the project.

Recommendations

To ensure that DWR manages WaterFix in an effective manner, DWR should complete both the economic analysis and financial analysis for WaterFix and make the analyses publicly available as soon as possible.

In order to prepare for the potential approval of WaterFix and to ensure that the project is managed properly during the design and construction phase, DWR should do the following:

- Develop an appropriate governance structure so that it is prepared to oversee the design and construction of WaterFix in the event it is ultimately approved.
- Develop and update when necessary the associated program management plan for the design and construction phase of the project.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (Audit Committee) requested the California State Auditor to examine the funds spent on planning and design of WaterFix by DWR. Table 2 lists this audit’s approved objectives and the methods we used to address them.

Table 2
Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed relevant laws, regulations, and other background materials related to the WaterFix project.
2 Determine how DWR collaborated to organize and fund the planning and design of the BDCP and subsequently WaterFix. Specifically, identify the following:	
a. DWR’s role in organizing and financing the planning and design.	<ul style="list-style-type: none"> • Interviewed relevant individuals and reviewed planning documents, including various planning agreements among participants and DWR’s funding agreements with the State Water Project water contractors, the Authority, and Reclamation. • Reviewed the BDCP and various drafts of the environmental impact report. • Reviewed a May 2008 Legislative Counsel opinion regarding DWR’s authority to construct a water conveyance facility.
b. The extent to which DWR engaged local agencies required to contribute towards WaterFix costs in developing the funding structure for planning and design.	<ul style="list-style-type: none"> • Interviewed relevant individuals at DWR, Metropolitan, Kern, and the Authority. • Reviewed relevant documents, including BDCP steering committee minutes from 2006 through 2010, BDCP management committee documents, WaterFix business committee documents, and conservation and conveyance program financial meeting agendas.
c. The amounts and proportional share of contributions each local agency and any other entity that provided funds for planning and design made from 2006 to present.	<ul style="list-style-type: none"> • Reviewed funding agreements to determine the funding obligations of entities participating in the planning phase. • Reviewed budgets and contracts DWR developed for the preparation of the BDCP beginning in 2006 to determine estimated costs because DWR did not track adequately BDCP contributions or spending. • Obtained data from DWR’s accounting system identifying participating state and federal entities and their proportionate contributions to the conservation and conveyance program’s planning costs from January 2008 through June 2017. • Traced the amounts from DWR’s data to supporting documentation from the two largest State Water Project water contractors (Metropolitan and Kern), the Authority, and Reclamation.
d. Whether the State allocated any General Fund money for planning and design.	<ul style="list-style-type: none"> • Reviewed state budget acts for fiscal years 2006–07 through 2016–17 to determine whether the State allocated any General Fund money for the planning of the BDCP and WaterFix. • Interviewed DWR staff to determine if DWR used General Fund money to fund the planning and design. • Analyzed the expenses from the fund that DWR set up for the conservation and conveyance program expenses to determine whether DWR used any General Fund money to fund the planning and design.

continued on next page...

AUDIT OBJECTIVE	METHOD
3 Identify, by source, the amounts of funding DWR, each local agency, and any related joint powers authority raised and used to finance the BDCP and subsequently WaterFix. In the case of debt financing, identify the entities that issued debt and their relationships to the water contractor and determine when and how they secured each debt issuance.	<ul style="list-style-type: none"> • Reviewed documents and data, as further described in Objective 2c. • Interviewed individuals at Metropolitan and Kern and traced their contribution amounts reported in DWR's data to the entities' audited financial statements to confirm the amounts and identify the sources of the funds. • Interviewed individuals at the Authority and obtained documentation of the Authority's 2009 revenue note issuance, repayment, and cost-sharing structure among its participating member agencies to determine the source of the funds. • Reviewed federal assistance agreements and interviewed individuals at Reclamation to determine the sources of its contributed funds. • Interviewed individuals at DWR to determine the need for any additional funding to carry out the remainder of the planning phase.
4 Determine the nature of the Conveyance Project Coordinating Agency's activities, date of its charter, its composition, and the amount of funding, by source, it has received since its inception.	<ul style="list-style-type: none"> • Interviewed individuals at DWR and reviewed relevant documentation. We determined that the water contractors have not created the coordinating agency; thus, it has no activities, no charter, and has not received any funding. DWR mentioned the coordinating agency in a draft agreement that DWR prepared to establish how DWR intended to manage the design and construction phase. DWR has not executed the draft. • We discuss the coordinating agency beginning on page 35 of the report.
5 Evaluate the process DWR used to select the contractor to manage design and engineering for the Design and Construction Enterprise Unit.	<ul style="list-style-type: none"> • Reviewed relevant contracts, contract amendments, emails, and other documentation regarding DWR's selection of the contractor to provide program management services for the conservation and conveyance program, and DWR's efforts to replace that contractor with Hallmark. • Interviewed individuals at DWR regarding the selection of the program manager for the conservation and conveyance program and regarding the subsequent replacement of that program manager with Hallmark. • Reviewed Statements of Economic Interests (Form 700s) for relevant DWR employees and contractors. We did not identify any apparent conflicts. • As we describe on page 36, the Enterprise Unit was never officially established, nor was a contractor selected to manage it.
6 Review and assess any other issues that are significant to the audit.	<ul style="list-style-type: none"> • Interviewed responsible individuals at DWR and reviewed management practices and policies, analyses, and agreements related to moving forward with the construction of WaterFix. • Reviewed and analyzed task orders and deliverables related to the contract for program management of the conservation and conveyance program and WaterFix.

Sources: California State Auditor's analysis of the Audit Committee's audit request 2016-132 and information and documentation identified in the table column titled *Method*.

Assessment of Data Reliability

In performing this audit, we obtained electronic files of conservation and conveyance program revenues and expenses from DWR's accounting system for January 1, 2008, through June 30, 2017. The U.S. Government Accountability Office, whose standards we are statutorily required to follow, requires us to assess the sufficiency and appropriateness of computer-processed information that we use to support our findings, conclusions, or recommendations. To gain assurance of the accuracy of these data, we traced the program revenues from the two largest state water contractors and all federal sources, which constitute 82 percent of the revenues, to supporting documentation from the responsible

entities and found that the dollar amounts materially matched. We performed completeness testing of these data by comparing the total program revenues from DWR's data to the budgeted amounts in planning documents and by ensuring that the data provided were not comingled with other data. We found the data to be complete. Consequently, we found DWR's data to be of sufficient reliability for the purposes of determining the amounts that the various state and federal contractors contributed.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: October 5, 2017

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October 2017

STATE OF CALIFORNIA – CALIFORNIA NATURAL RESOURCES AGENCY

EDMUND G. BROWN JR., Governor

DEPARTMENT OF WATER RESOURCES

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September 28, 2017

The Honorable Elaine M. Howle*
State Auditor
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, California 95814

California WaterFix Audit, State Audit Report No. 2016-132

Dear Ms. Howle:

On behalf of the Department of Water Resources (DWR), I am writing to address Draft Audit Report No. 2016-132 (Report) regarding the project that eventually developed into, and was recently approved, as the California WaterFix.¹ DWR appreciates the professionalism of the Bureau of State Audit staff and their openness to hearing DWR perspectives.

DWR is pleased that after 10 months of investigation, the Report validates that no General Fund money has been used for the planning and design for WaterFix. (Report p. 4.) All activities for the planning and design of the project were supported and paid for by the public water agencies that will benefit from the project. ① ②

The Report also finds the project's complexity resulted in unforeseen expenses and schedule extensions. We appreciate this acknowledgement. WaterFix is unprecedented both in the scale of its complexity and the extent of its public and stakeholder engagement. DWR has worked diligently to address concerns as they emerged and has made significant changes to the project in direct response to input from the public and regulatory agencies, including analyses of additional alternatives, additional species evaluations and optimization of the project. These changes required additional time and funding to implement.

The Report's primary concern involves the way DWR documented project decisions and selected the program manager. DWR agrees that decisions should be documented. We also agree that a governance structure is critical for a project of this scope, and one has been in development and will be ready for implementation at the appropriate stage of the project.

¹ For convenience, we refer to the project variously known as Delta Habitat Conservation and Conveyance Program, the Bay Delta Conservation Plan, and California WaterFix as "WaterFix" throughout these comments.

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In addition, DWR agrees that a financial analysis is important, and is prepared to complete a final economic analysis when each potential participant in WaterFix has made its decision to opt into the project.

- ③ We must respectfully disagree with the Report's conclusion that DWR did not follow state law in selecting the project manager. As project needs changed, DWR reassigned the project management task consistent with the terms of the contract and pursuant to DWR and state policies. The facts demonstrate the high value that DWR and the project have received from the project manager's performance.

WaterFix is a science-driven project that will upgrade the state's outdated water delivery system and maintain a reliable source of water for 25 million Californians and more than 3 million acres of farmland in the San Francisco Bay Area, Central Valley and Southern California. It is a critical element of the state's overall strategy to address climate change and ensure a reliable water supply for the future, as outlined in Governor Brown's California Water Action Plan.

The extensive outreach and responsiveness to stakeholder and public input described above resulted in what many considered unachievable: the issuance of permits from state and federal agencies to move forward with a viable and achievable long-term solution to decades-old problems in the Bay-Delta. Consistent engagement with the local public agencies funding the project has allowed for close scrutiny of any increased costs and changes to the project, affecting the scope and schedule. These local agencies have found the additional work on the project to be reasonable and necessary.

DWR's response to the Report's findings is summarized here, followed by detailed discussion of each, and concludes with our comments on the Report's recommendations.

④ Summary:

1. DWR Received Excellent Value and Quality for Services Under the Hallmark Group Contract
2. The URS Contract Authorized Multiple Tasks; Only One Task was Construction
3. Requiring a Subcontractor to Provide Program Management Services to URS was Necessary and was Appropriately Defined
4. DWR Followed Proper and Lawful Procedures in the Necessary and Appropriate Replacement of the Program Manager
5. The Structure of The McKinsey Contract was Beneficial to Both DWR and the Public Water Agencies that Will Ultimately Pay for the Project,
6. DWR Developed a Governance Structure for Implementation at the Appropriate Project Stage

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7. DWR Will Prepare a Financial Analysis and Economic Analysis When WaterFix Participants are Identified
8. DWR Has Performed Significant Planning During the Planning Stage and Has Maintained and Provided Extensive Documentation

Our comments will address the Report's specific findings, and then address the Report's recommendations.

A. FINDINGS

1. DWR Received Excellent Value and Quality For Services Under The Hallmark Group Contract

The Report devotes a full one-fourth of its length to DWR's hiring and subsequent utilization of the Hallmark Group (Hallmark) to provide program management services for what has become California WaterFix. In these sections, the Report finds that Hallmark's program manager did not appear to possess the qualifications DWR required when it selected contractor URS, and that the failure to ensure Hallmark possessed these qualifications was contrary to the letter and spirit of the law, which is intended to create competition to ensure that the state obtains a competent and qualified contractor at a fair and reasonable price. Finally, the Report notes that DWR "potentially" did not receive "the best value for the contracted services." (Report p. 27-29.) DWR addresses the contracting issues later in this response, but here, we note the facts about Hallmark's performance are contrary to the above statements in the Report. The state received excellent value and a high work product for the services Hallmark provided. ①

When URS was hired for WaterFix, the project was conceived as an engineering enterprise, to be staffed and managed by engineers. After little more than a year, it became apparent to DWR and its stakeholders that engineering expertise alone would not be sufficient to manage the project; efficiency and management expertise would be essential in successfully moving the project forward. ⑤

As described by former DWR Director Lester Snow, the almost exclusive motivator to bring the Hallmark Group on as program manager was cost control. The entities funding WaterFix, the water contractors, were impressed by Hallmark's work managing the \$500 million UC Merced campus construction project and presented a united front in urging Hallmark be utilized to increase efficiencies on the project. Hallmark's job was to scrutinize costs, monitor schedules and ensure that tasks were completed on time. Hallmark's task did not include performing engineering work, such as deciding what approach (canals, tunnels, or levies) should be used. ⑥

Hallmark was not a substitute for URS expertise in large water infrastructure management. Rather, when added as a subcontractor, the Hallmark Group augmented

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- ⑧ URS' engineering expertise by providing proven project management skills. Later in the program, the contract was divided, with program management being assigned to Hallmark, and URS retaining engineering tasks.
- ⑥ Addition of a specialized program management team made sense. Not all engineers make great managers. Management excellence transcends the field in which one is trained: many exceptional managers succeed in overseeing work in specialized fields
- ⑧ not because of their particular scholarly training, but because of the strength of their leadership and management abilities.
- ⑤ ⑦ Hallmark has succeeded in the task which it was originally brought on board to provide, cost control. As stated repeatedly by the participating public water agencies and DWR, Hallmark has done an outstanding job managing WaterFix. For example, within a year of being hired, Hallmark reduced staffing on the project by 40 percent, reduced monthly burn rate costs by 44 percent, and within two years costs were reduced by 65 percent.
- ⑨ Further, Hallmark dramatically increased program efficiency, enabling WaterFix to take a budget projection intended to last for three years through an initial projected project approval of April 2012, and extend it to cover nearly five years of unanticipated additional work through project approval (the California Environmental Quality Act Notice of Determination) in July 2017.

Over time, WaterFix evolved, transitioning from a Habit Conservation Plan to an Endangered Species Act section 7 process, resulting in further revisions to the schedule. On two different occasions in 2013 and 2014 Hallmark developed ramp down plans to further contain costs allowing the project to continue the environmental process. Beyond its obvious cost control success, Hallmark provided excellent leadership by keeping the teams organized, the stakeholders completely informed and an unflagging focus on resolution of issues as they developed.

California water law and policy is extremely complicated, making all water development projects protracted and therefore challenging—not least of which a project like WaterFix. There will be many more challenges to overcome in the future. The Hallmark Group has provided indispensable assistance to DWR, enabling the Department to reach this point of the process.

2. The URS Contract Authorized Multiple Tasks; Only One Task Was Construction

- ⑩ The Report characterizes the URS contract as one for “construction project management, which a licensed engineer or general contractor must perform under state law.” (Report, p. 24.) This is a misunderstanding of the URS contract, which can be readily understood by reviewing the contract’s scope of work which states the services contracted for included:
- ①

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[E]ngineering support services and the program management of the planning, coordination and oversight of the programs, environmental engineering and construction phases, strategic program development, risk assessment and oversight of program costs and schedules of DWR's Delta Habitat Conservation and Conveyance Program (DHCCP). (Contract 46-00008104, p. 1, attached hereto as Exh. 1.)

Thus, the contract DWR made with URS authorized a number of tasks to be performed, including strategic program development, planning, coordination and oversight among other tasks. It is inaccurate to summarize the above services as "construction project management." Rather, construction is one element of a multi-element program where oversight of environmental engineering, strategic program development, risk assessment and oversight of program costs and schedules are equally or more important. At the time the contract was made, comparatively little environmental analyses was performed for the project, there was no overall project plan, and no environmental permits had been obtained. The Report's incomplete characterization of the URS contract appears to undermine the Report's conclusions. ⑩

3. Requiring A Subcontractor To Provide Program Management Services To URS Was Necessary And Was Legally Justified

The Report criticizes the manner in which DWR utilized Hallmark, a subcontractor, to provide project management services for the prime contractor. It asserts that this 2008 subcontract "does not appear to be a contractor-subcontractor arrangement" and is different from what the Report believes to be a "traditional contractor-subcontractor relationship." The Report further criticizes sections of the subcontract that details how DWR expected Hallmark to work as program manager with DWR and with URS staff. (Report p. 28.) ⑪

The URS amendment made clear the uniqueness of the program management function, performed as a subcontract, and provided clear specific provisions to prevent any conflict. (Contract No. 4600008104, Am. 1, Exhibit E, Attachment 6, attached hereto as Exh. 2.) The subcontract to Hallmark was to provide a specific service – program management. In order to accomplish this function it was essential that Hallmark, as the program manager, exercise the functions typically performed by that position, including general direction and reporting, tasks which are essential for a program manager to perform in order to successfully manage WaterFix. ①

The URS amendment provided comprehensive details, "... in order to avoid the appearance of or any actual conflicts that might arise from such an arrangement" (*Ibid*, page 1.) For example, the contract required Hallmark to submit all invoices to URS, whereupon URS would submit the invoice to DWR for approval while Hallmark

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was to provide program management functions by communicating and coordinating with URS. The roles and responsibilities of the parties to the agreement were clearly defined by the amendment. The amendment proved successful to the program, as demonstrated by the high level of performance for the three years duration in which the amendment was in effect.

⑫ ⑤

4. DWR Followed Proper Procedures in Replacing the Program Manager for the Conservation and Conveyance Program.

a. The URS Subcontracting of Program Manager Responsibilities to Hallmark was Both Necessary and Lawful.

The Report's finding that DWR "... later used other methods to select a replacement program manager, and these methods did not follow the competitive process required under the law" does not take into account applicable statutes, regulations and contract terms permitting the replacement. DWR's replacement of the WaterFix program manager was in full compliance with the law.

- ⑪ As explained above, the URS contract expressly permitted subcontracting, the terms of which DWR followed in selecting the Hallmark firm. (Contract No. 4600008104; Exhibit D, paragraph 6, attached hereto as Exh. 3.) Architectural and Engineering ("A&E") contracts are frequently amended to subcontract for specialized services, replacement personnel, program changes, and for other reasons. Such amendments permit DWR to accomplish cost effective, specialized services as program needs change or require. The original URS contract was for a term of 7.5 years for a project that the Report recognizes presented "unexpected complexity." A contract for such a lengthy term for such a complex project will by necessity require modifications and changes consistent with law. When it became apparent that the assigned URS program manager was not able to devote himself full-time to the project, and that the program required a stronger emphasis on cost containment, it became essential for DWR to subcontract for a program manager to ensure effective continued progress of the contract.
- ⑦
- ⑥

The Legislature intended that the A&E process be liberally construed to accomplish its purposes. (Gov't Code § 4529.19.) Specific legal authority permitting modification of A&E contracts is provided by DWR regulation:

Where the Director determines that a change in the contract is necessary during the performance of the services, the parties may, by mutual consent, in writing, agree to modifications, additions or deletions in the general terms, conditions and specifications for the services involved, including extensions of time,

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with a reasonable adjustment in the firm's compensation.
(23 Cal.Code Regs § 387.)

Lester Snow, DWR Director in 2008, determined that a change in the contract was necessary and effected a change. There is no indication that Director Snow failed to sufficiently assess the qualifications of Hallmark in doing so. (8)

The Report narrowly focuses on the Request for Qualifications (RFQ) process as the sole mechanism to replace the WaterFix program manager. But the contract itself, as well as DWR's regulations, provides another equally appropriate path. (13)

Indeed, the circumstances on the ground indicate why DWR's approach to contract amendment was appropriate. For example, as the contract performance was already in its 13th month, an RFQ selection process, even when given a high priority, would have required at least five months to obtain a new program manager. The program could not afford the absence of the program manager for such a lengthy period of time. Had an RFQ been utilized, it would likely have significantly delayed the project and incurred higher costs while waiting five months for a replacement program manager. Given the authorized alternative approach that DWR took, a "competitive" RFQ selection process for replacing the program manager was simply not a realistic or optimal option.

b. It Was Not Necessary That Hallmark As A Subcontractor Be An Engineer or Licensed Contractor.

The Report faults Hallmark for not having engineering expertise, but the contractor team as a whole provides all necessary expertise. As a subcontractor, Hallmark was a member of the URS team. The team, including URS, retained all the engineering/licensed contractor knowledge that was required to perform the services required under the contract. As the contract itself stated, the contract had many purposes well beyond just engineering. (14)
(11)

Government Code section 4529.5 requires any individual or firm to have requisite experience to provide construction project management services.² The firm, URS, had engineering expertise before Hallmark was assigned to provide program management

² Section 4529.5 states the following:

Any individual or firm proposing to provide construction project management services pursuant to this chapter shall provide evidence that the individual or firm and its personnel carrying out onsite responsibilities have expertise and experience in construction project design review and evaluation, construction mobilization and supervision, bid evaluation, project scheduling, cost-benefit analysis, claims review and negotiation, and general management and administration of a construction project.

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- ⑭ services and afterwards. All requisite engineering qualifications were retained within the URS contract to be performed by URS personnel after Hallmark was added to the team.

The URS contract's terms make clear that "... the various areas of expertise required of the successful Program Management team include planning and implementation of . . . engineering and construction program phases." (Exh. A, attached hereto at p 1, emphasis added.) No one person has all of the qualifications necessary to perform all of the services under the contract. It is a team approach, here contained within URS and its subcontractor Hallmark.

c. Assignment of Program Management Responsibilities to Hallmark Was Appropriate and Legally Supportable

- ⑮ DWR respectfully submits that the Report incorrectly concludes that the 2013 contract assignment to Hallmark violated the law and, instead, should have been accomplished through a competitive RFQ process. (Report pp. 29-30.) With the essential engineering expertise firmly in place, DWR determined that to improve workflow efficiencies and to save the 5 percent subcontractor markup costs imposed by URS, it was necessary to assign program manager responsibilities directly to Hallmark.

- ⑮ The Hallmark assignment was for the initial planning, coordination, and oversight of WaterFix. The engineering, environmental and construction management functions remained separately as a continuing part of the URS contract. The program manager responsibilities had already been performed by Hallmark for the three preceding years prior to the assignment. DWR management was satisfied with Hallmark's performance and Hallmark was experienced and successful in managing the program. Given Hallmark's success, there appeared to be no benefit from introducing a new less-experienced program manager to replace the successful incumbent and disrupt the continuity of the program. DWR determined that given Hallmark's experience and demonstrated performance, it was clearly the most qualified contractor to perform the assignment function.

- ⑬ Nor did it make any sense to adjust the timeline for the program for five months in order to submit an RFQ to replace the successful program manager not to mention the additional time required for a new untested program manager to become knowledgeable of the program's requirements. For the success of the WaterFix program, it was important to keep the existing program manager and maintain continuity.

- ⑮ The contract assignment was accomplished lawfully. As previously mentioned, DWR's regulations permit the Director to make a change in an A&E contract when necessary. (See 23 Cal.Code Regs § 387 ["Where the Director determines that a change in the contract is necessary during the performance of the services, the parties may, by mutual consent, in writing, agree to modifications, additions or deletions in the general

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terms, conditions and specifications for the services involved. . .].) The Director appropriately determined that a change was necessary, for the reasons stated above, to help ensure the success of the program.

Finally, the URS contract contained a specific provision regarding contract assignments:

GTC 307, 3. ASSIGNMENT: This agreement is not assignable, either in whole or in part, without the consent of the State in the form of a written amendment.
(Contract 4600008104, Exhibit C, paragraph 3, attached hereto as Exh. 4.)

Further, state law allows contracts to be assigned without a new competitive bidding process. DWR followed state law, its own regulations and the contract terms in the January 2013 contract assignment of program management responsibilities to Hallmark. (15)

5. The Structure of the McKinsey Contract Was Beneficial to Both DWR and the Public Water Agencies That Will Ultimately Pay for the Project

The Report finds that DWR did not ensure that the price paid for work product produced by subcontractor McKinsey & Company (McKinsey) was fair and reasonable. (Report, p. 31.) It may be difficult to appreciate today, but when DWR authorized the work performed by McKinsey in 2012, it was widely believed by DWR and its stakeholders that the WaterFix (then the BDCP) project would be approved in 2013, and construction would commence shortly thereafter. Even after substantial prior work by DWR and its WaterFix program manager there was still no consensus among stakeholders about how the project would be managed during construction. In June 2012, DWR and its WaterFix stakeholders determined to retain highly specialized consultants tasked with resolving these fundamental issues, and to resolve them in an expeditious manner to match the perceived tight time schedule. (17)

DWR initially contemplated six consultants, McKinsey, Bain, Boston Consulting, Monitor, Booz/Allen/Hamilton, AT Kearney, and KPMG. In July 2012 multiple prospective qualified consultants were interviewed by phone, reducing the number of candidates to two, McKinsey and KPMG. These candidates were interviewed by a DWR/water contractor panel, and McKinsey emerged as the top ranked firm. References provided by McKinsey were interviewed, with interviewees reporting outstanding consultant performance and extraordinary results on projects with similar challenges. A fee for the work plan was established. (17)

DWR determined the work required to produce the product was appropriately valued at \$2.6 million. Due to the expedited timeline, a fixed price contract task order was utilized to establish a time frame and to control costs. DWR maintained control of the final

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product and the value derived. As the amendment to the contract authorizing this work noted, "The structure of the contract, fixed fee based on deliverables, is beneficial to both DWR and the stakeholders that will ultimately pay the costs for this consultant, since the consultant is only authorized to bill the fixed price for deliverables that have been accepted and approved, as opposed to hourly labor each month." (Contract 4600008104, Am. 5, Std 215, p. 3, attached hereto as Exh. 5.)

6. DWR Developed a Construction Governance Structure For Implementation at the Appropriate Project Stage

- ⑱ ① The Report (pp. 37-38) implies no governance structure exists and that lack of a governance structure for implementation of the WaterFix is somehow contrary to DWR's legal requirements. This implication is not supported by the facts. DWR has always had the legal authority to carry out the project itself. There is no legal requirement that it have a governance structure in place prior to approval of a project. Based on recommendations by McKinsey, DWR developed a governance structure in the last quarter of 2012. DWR posted the governance structure on the BDCP website and it has been publicly available since January 2016. When a decision is made regarding public water agency participation, a structure will be ready for implementation at the appropriate time and will be able to draw on the substantial materials already prepared during the work with McKinsey.

7. DWR Will Prepare a Financial Analysis and Economic Analysis When WaterFix Participants Are Identified

- ① As the Report noted, DWR cannot complete a final economic analysis until individual water agencies define their level of involvement in WaterFix. We are pleased the Report reflects this consideration. (Report, p. 35.)
- ⑱ ① With regard to the WaterFix financial analysis, the Report appears to suggest that DWR must assess each water agency's needs and provide a final financial analysis before the decision to opt in to WaterFix is made. (Report, pp. 36-37.) This is not correct: DWR's contractor Public Finance Management has already provided a wide range of financing options to water contractor governing boards as tools to enable each contractor to determine what financing option would best work for them. To date, we have received no requests for additional information. Once individual agencies decide to participate, financing will be tailored to meet each agency's needs. There is no need to prepare a full financial analysis for each potential participant in WaterFix before the decision is made to opt in to the project.

8. DWR Has Performed Significant Planning During The Planning Stage and Has Maintained and Provided Extensive Documentation

The Report states DWR failed to update its Program Management Plan (PMP) and suggests that the absence of a PMP meant there was little or no documented WaterFix

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planning effort. Although DWR did not update the PMP itself, DWR has maintained an extensive record of program management documents meeting the same planning function. DWR has provided State Auditor full access to all of the program management and planning documents on the program manager's database, Acononex, and on multiple occasions provided them with physical samples. These documents included but were not limited to documentation for the Business Committee, Core Policy, DCE, EIR/S, Biological Opinion, Project Manager, Finance, engineering, Request for Qualifications, major agreements, budget reports, invoices, and deliverables. Maintaining the critical project documentation throughout the program has been performed. (20)

Although DWR experienced management changes, as an industry best practice, DWR required that the program manager maintain all work plans and associated documents to provide continuity for the project. This practice provided seamless transitions without loss of institutional knowledge. This proved to be a successful strategy as the project continued to make consistent progress throughout management changes.

As evidenced in the program documents, as early as 2012 DWR anticipated project approvals by the federal and state participants and began preparing to transition to the design and construction phase. DWR began the update to the PMP for the design stage, but unexpected complexities of the project forced a delay in implementing the design stage and the PMP update effort was put on hold. Given the constantly changing nature of the planning process, DWR managed the project from workplans that could quickly be developed and implemented to react to changing conditions, which proved to more efficient than constantly updating the planning PMP.

B. RECOMMENDATIONS

In this section of DWR's comments, DWR provides a response to the Auditor's recommendations made throughout the report. Since the recommendations are not consecutively numbered, DWR identifies them by the page on which they appear. DWR's response to the recommendation is provided in italicized text.

(Report, p. 21) To improve management of large and complex infrastructure projects, the Legislature should enact legislation requiring agencies to publicly report significant changes in the cost or schedule of such projects if they are expected to exceed their established budgets by 10 percent or schedules by 12 months. (1)

The Department will continue to abide by any existing or new laws, and takes no position on this general recommendation to the Legislature.

(Report, p. 21) To better manage large infrastructure projects, DWR should develop and implement a project reporting policy requiring its management staff to document and justify decisions to proceed with such projects if they are expected to (1)

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exceed their established budgets by 10 percent or schedules by 12 months. DWR should make these documented decisions and justifications publicly available and submit them to the Resources Agency for review and approval.

This recommendation does not make a distinction between the planning phase of a project and the design and construction phase. DWR believes this is an important distinction, as evidenced in the Report's findings for the planning phase of the WaterFix. The recommendation presupposes that an extension of time during a project planning phase is something that has a negative consequence. This recommendation has limited applicability here, since decisions regarding this project were made in response to stakeholder input and public comments to increase the range and scope to better meet the needs of the state. The planning process for large infrastructure projects is complex and subject to changing requirements and scope from a variety of sources including regulating agencies, project proponents, stakeholders, and the public at large. As seen with WaterFix, this results in increases in scope and schedules that are beyond the control of DWR. Limiting the Department's ability to be responsive to stakeholder input during complex "planning" efforts would be counterproductive.

②1

- ① (Report, p. 22) To ensure it makes appropriate use of its growing surplus revenue balance, by December 2017 DWR should develop a detailed plan describing how it intends to use these funds.

The Department is already in the process of preparing this plan related to Water Code section 12937(b)(4) funds.

- ① (Report, pp. 32-33) To fully comply with state contracting law, DWR should ensure that it competitively selects architectural and engineering consultants based on demonstrated competence and professional qualifications. In addition, DWR should document in the contract file its evaluation of the competence and professional qualifications of all contractors and any subcontractors that are added to the contract subsequent to the competitive selection process.

- ③ *The Department will continue to comply with state contracting law including the process outlined above.*

- ① (Report, p. 33.) To ensure that only qualified subcontractors are added to contracts after the initial award is made, DWR should make sure that contractors select their own subcontractors and that DWR subsequently approves the selection after it verifies their qualifications.

- ②2 *It is essential that DWR work with a contractor to identify the specific tasks for which a subcontractor will be required. Additionally, it is important to convey to the contractor the expertise and qualifications necessary of the subcontractor in*

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order to ensure the most highly qualified subcontractor is chosen to accomplish the specified tasks. The Report's Recommendation, above, isolates DWR from such consultation. Without these communications, time is unnecessarily expended while the contractor attempts to obtain a suitable sub-contractor without the benefit of input from DWR. The recommended edit below allows for the indispensable communications necessary to successfully obtain, and approve, subcontractors.

Proposed Revision: To ensure that only qualified subcontractors are added to contracts after the initial award is made, DWR should make sure that contractors select their own subcontractors in consultation with DWR and that DWR subsequently approves the selection after it verifies their qualifications (Report, p. 33). ② ①

(Report, p. 33) DWR should ensure that it retains documentation in its contract files to support that contract prices are fair and reasonable. ①

The Department agrees to adopt the above recommendation.

(Report, p. 41) To ensure that DWR manages WaterFix in an effective manner, DWR should complete both the economic analysis and financial analysis and make the analyses publicly available as soon as possible. ①

As planned, the Department will release completed versions of these reports as soon as practicable. This will necessarily follow the determinations currently being contemplated by the public water agencies regarding level of participation.

(Report, p. 41.) In order to prepare for the potential approval of WaterFix and to ensure that the project is managed properly during the design and construction phase, DWR should do the following: ①

- Develop an appropriate governance structure so that it is prepared to oversee the design and construction of WaterFix in the event it is ultimately approved.

A governance structure will be ready to be implemented to oversee the design and construction of WaterFix in the event it is ultimately approved.

- Develop and update when necessary the associated program management plan for the design and construction phase of the project.

The Department agrees to adopt the above recommendation.

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We appreciate this formal opportunity to respond to the Draft Audit Report No. 2016-132. If new evidence presents itself in the finalizing of this draft Report, DWR requests the opportunity to respond to such new information, which the Auditor may send to Deputy Director Taryn Ravazzini at taryn.ravazzini@water.ca.gov.

Sincerely,

A handwritten signature in black ink, appearing to read "Grant Davis", is written over the word "Sincerely,". The signature is stylized and cursive.

Grant Davis
Director

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Attached Exhibits

1. URS Contract, Exhibit A (Scope of Work)
2. URS Contract, Amendment 1, Exh. E, Attachmt 6 (Covenants)
3. URS Contract, Exhibit D (Special Terms and Conditions)
4. URS Contract, Exhibit C (General Terms and Conditions)
5. URS Contract, Amendment 5, Std. 215 (Agreement Summary)

Exhibit 1

Contract No. 4600008104

Exhibit A

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Exhibit A Scope of Work

BACKGROUND:

The Department of Water Resources (DWR) requires the services of a consultant firm to assist with engineering support services and the program management of the planning, coordination and oversight of the programs, environmental engineering and construction phases, strategic program development, risk assessment and oversight of program costs and schedules of DWR's Delta Habitat Conservation and Conveyance Program (DHCCP).

DWR manages the water resources of California in cooperation with other agencies, to benefit the State's people, and to protect, restore, and enhance the natural and human environments. DWR operates California's State Water Project (SWP), the largest State-built multipurpose project in the United States. Through the SWP, DWR supplies good quality water for municipal, industrial, agricultural, and recreational uses and for protecting and enhancing fish and wildlife.

The heart of DWR's vital water supply system, the Sacramento-San Joaquin Delta, is in jeopardy of collapse without both immediate action and long term solutions to restore the ecosystem and protect water supplies. DWR is tasked to improve the Delta water conveyance system. DWR will also coordinate with the Bay Delta Conservation Plan to provide a foundation to help conserve the Delta ecosystem and a reliable water supply for California.

PURPOSE:

DWR requires a highly qualified firm with extensive experience to provide engineer support services and Program Management (PM) for the DHCCP under the DWR's direction. Some of the various areas of expertise required of the successful Program Management team include planning and implementation of large water resources infrastructure, strategic program development, project management, program risk assessment, oversight and coordination of environmental, engineering, and construction program phases. The PM Contractor will provide program management expertise of comparable size water resources programs but only at the direction and auspice of DWR authorized representative. Based on conceptual level estimates the DHCCP is anticipated to be in the range of 4 to 5 billion in present dollars.


DESCRIPTION:

- A. The PM Contractor will serve as the DHCCP Program Manager and provide program/project management, coordination and oversight over the planning, development, coordination, and implementation of the DHCCP. The PM Contractor will provide necessary staff, including ancillary services in support of this effort, as required to support the DHCCP and manage the integration of DWR and Contractor staff to effectively implement the DHCCP as authorized and approved by the DWR authorized representative. It is DWR's expectation that the DHCCP Program Manager's team be fully integrated with DWR internal staff to effectively manage the implementation of the DHCCP. Upon approval, the PM Contractor will be authorized to perform the work per the contract within the funding and time limits outlined.
- B. The PM Contractor shall be responsible for the professional quality, technical accuracy, and the coordination of all services furnished. Support service, including engineering, will be provided as needed to support DWR staff but only on a temporary basis. The PM Contractor shall, without additional compensation, correct or revise any errors or deficiencies in its work products including management reports, costs, schedules, risk analysis, drawings, specifications, and other engineering support services.
- C. The PM Contractor will provide their best skill and judgment in discharging all duties and will promulgate and implement, efficient business administration, including best practices, and use their best efforts to complete the work in an expeditious and economical manner consistent with the best interest of DWR.
- D. The PM Contractor shall maintain financial information both in written form and electronically as required by DWR including: books, records, documents, copies of receipts, and other evidence pertinent to the performance of the work in accordance with the provisions of this Scope of Work. In addition, financial information shall be compiled in accordance with consistently applied, generally accepted accounting principles, and made available for auditing purposes by authorized representatives of DWR or the State of California. Financial information shall be maintained until three years after the date of final payment for the work in accordance with the provisions of this Scope of Work. In addition, financial information and other program records shall be transferred to DWR upon their request and timelines.
- E. The PM Contractor's staff shall be experienced in the use of software that is compatible with DWR's requirements in accordance with Exhibit D.10.

Contract No. 4600008104

Exhibit A

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- F. Resumes containing the qualifications and experience of the PM Contractor's personnel shall be submitted to the Division of Engineering's (DOE) Contract Manager for review prior to assignment on the DHCCP. If in the opinion of DOE's Contract Manager an individual lacks adequate experience, the PM Contractor's employee may be accepted on a trial basis until such time as the individual's ability to perform the required services has been demonstrated.
- G. The DWR's DOE will have the ultimate responsibility of determining the quality and quantity of work performed by the PM Contractor's personnel. If, at any time, the level of performance is below expectations, DWR may release PM Contractor's personnel and request another person assigned as needed. DWR reserves the right to disapprove the assignment or the continuing assignment of specific contractor personnel, subcontractors, and subcontractor personnel. The PM Contractor's withdrawal of said personnel will be immediate upon DWR's Notice of Disapproval. Replacement personnel must be approved by DWR prior to their participation in the contract. Replacement personnel must report within seven calendar days after DWR approves PM Contractor personnel. Resumes will be required for any new personnel of the PM Contractor or subcontractor.
- H. The PM Contractor is required to submit a written request and obtain the Chief of DOE approval at least 30 calendar days prior to changing previously approved lead program management staff. The PM Contractor is required to provide the DWR authorized representative with the technical qualifications of proposed replacement staff if allowed by DWR.
- I. As the PM Contractor will be involved in coordinating and overseeing the work of other firms under contract for this program, the PM Contractor shall agree in writing that neither it nor any of its subsidiaries will submit proposals or bids for any other DHCCP contract work related to but not limited to environmental and engineering and construction services. The written agreement shall remain in force until one year after the completion of this contract. If the PM Contractor is a subsidiary of another company, the other company shall also make this written commitment.
- J. The PM Contractor shall not receive compensation for any services that are found to be in conflict of interest. In the event of non-acceptance due to discovery of conflict of interest, the PM Contractor shall provide replacement deliverables free of any conflict of interest prior to payment. In the event replacement deliverables are not possible, the PM Contractor shall not receive compensation for the deliverables containing conflict of interest.
- K.  DWR does not guarantee, either expressly or by implication, that any work or services will be required under this contract. In addition, as the scope is developed, DWR reserves the right to add or delete related tasks as the

Contract No. 4600008104

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program evolves. In reference to the amount shown on the Standard 213, Item 3, the estimated amount of \$60,000,000 can be decreased or increased by amendment to allow for program changes as the scope is more fully developed.

AVAILABLE INFORMATION:

The DWR will provide the selected PM Contractor existing and available studies, plans, and other information acquired by DWR that would be useful for the program.

PROCUREMENT AND CONTRACTING:

The PM Contractor will answer directly to DWR as lead Contractor. DWR will administer the contract and pay invoices submitted by the PM Contractor in accordance with Exhibit B. DWR will issue task orders for specific work assignments, tied to the contract in accordance with Exhibit A, Attachment I. Each task order will be budgeted, scheduled and compensated in accordance with Exhibit B, Attachment I, not to exceed limit.

DWR will take the lead in issuing task orders for this contract, and will be the sole source in directing the PM Contractor. DWR will work with PM Contractor to develop the task orders. Unless otherwise directed by DWR, any and all work performed by the PM Contractor and its sub-contractors in preparation of this contract shall be submitted directly to DWR.

DELIVERABLES:

The PM Contractor will be responsible for, but not limited to, the following services:

1. Under the general direction of the DWR authorized representative the PM Contractor will successfully implement the DHCCP, work cooperatively with DWR and other staff.
2. Develop and deliver presentations to DWR management and stakeholders, as required by DWR, on the status, direction, schedule, budgets, cost, and other applicable items related to the DHCCP.
3. Prepare and review required reports, correspondence, other documents related to the DHCCP as necessary, and provide timely comments, findings, and recommendations to DWR management in accordance with issued task orders.

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Exhibit A

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4. Provide timely notifications and recommended actions to DWR management regarding significant issues that could or would impact the DHCCP.
5. Develop a PM Plan for the DHCCP that includes project budgets, needed resources, schedules, quality assurance, quality control, and performance measures in accordance with issued task orders. Ensure and report on cost, schedule, including significant milestones and meetings, and resources as compared to established baselines and provide corrective action and notification to DWR when variances occur.
6. Develop overall safety program and plans in conformance to DWR, State, and Federal policies, rules, and regulations. Also provide and foster good safety practices.
7. Coordinate, oversee, and monitor other DHCCP contractors including but not limited to environmental, engineering and construction services.
8. Establish and maintain a library of all DHCCP program/project documents electronic and written.
9. Develop scopes of work for other service contracts required for the DHCCP as directed by DWR.
10. Coordinate and provide oversight on construction contract bidding packages for procuring engineering and construction services in accordance with DWR procedures and policies.
11. Provide oversight, analysis, and quality control as required by DWR of other contractors associated with DHCCP to ensure contractual requirements are consistent and complete.
12. Assist in other service contracts required for DHCCP upon approval by DWR in accordance with issued task orders.
13. Develop and maintain a claims avoidance program throughout all phases of the program.
14. Develop a uniform format and editorial style manual for program documents in cooperation with DWR.
15. Maintain all financial records related to the Program Manager contract.
16. Coordinate and provide oversight with contractors related to the DHCCP including reviewing, auditing, and assisting with the processing of invoices.

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17. Prepare and maintain specific plans and reports, such as the PM Plan, Milestone Schedule, Environmental Status Report, Engineering Status Report, Construction Status Report, Cash Flow Report, Project Close-Out Report, and Program Status Reports for DWR management along with other reports as needed.
18. Cooperate in a timely fashion with DWR to provide necessary program documents in response to any internal review and audit requests.
19. Implement a program management information system for budget, schedule, and records management and reporting to support this effort and in accordance with DWR issued task orders. PM information system shall be compatible and interface with DWR's Information systems and requirements as specified in Exhibit D.10.
20. Define the business processes and program procedures necessary to implement a comprehensive program control system.
21. Prepare and maintain a work definition system that incorporates the work breakdown structure and the organization breakdown system translating functional requirements into identifiable elements of work as required.
22. Prepare and maintain a cost control system that measures expenditures and changes for program work elements, and measures them against established performance baselines as required.
23. Coordinate and provide cost estimating support to establish budgets and verify environmental, engineering and construction, and other project cost estimates as necessary.
24. Prepare Critical Path Method comprehensive program schedules addressing all program activities from program development through program close-out, measuring progress against these schedules, identifying and reporting trends and variances and recommending corrective actions.
25. The DHCCP control system shall also accurately display contracted, revised and forecasted costs for other contracts including environmental, engineering and construction contracts from award through completion.
26. Coordinate, monitor, and effectively integrate the work of the environmental contractor team with program management efforts, other appropriate DHCCP contractors, and DWR project teams.

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27. Coordinate with DWR staff and provide assistance when required for the review of environmental cost estimates, schedules, and quality control of project work, and reports on program status.
28. Monitor, document, and report on the environmental contractor's conformance with budget, schedule, and overall performance of the work.
29. Coordinate, monitor, and effectively integrate the work of all DHCCP project teams, including but not limited to planning, environmental, real estate, mapping, engineering, construction, operations, etc.
30. Coordinate with DWR staff and provide support, when required, to provide technical engineering and constructability reviews, value engineering reviews, and reviews for operability, maintainability, and project reliability.
31. Coordinate with DWR staff and provide support, when required, to review the engineering cost estimates, project schedules, quality control of project work, and report on program status.
32. Coordinate, oversee, and monitor the engineering contractor's conformance with respect to budgets, costs, schedules, and overall performance of the work.
33. Coordinate with DWR staff and provide support when required of the review of all construction contract documents to ascertain that they are descriptive, complete, and in accordance with applicable codes, regulations, and design criteria prior to DWR's final approval and contract advertisement.
34. Assure adequate preparation and scheduling for pre-bid, pre-construction, progress, coordination, completion and project close-out meetings. This includes the preparation of all necessary notices, forms, documents, hand-outs, agendas, attendance records, minutes, action item lists and proper filing of meeting documents.
35. Assure responses to requests for clarifications/information, assistance, access, quotation, and coordination by other contractors is provided accurately and in a timely manner.
36. Oversight of work progress and inspection of the work placed to ascertain compliance with contract documents, industry standards, site security and safety, testing, housekeeping, budget quality, and schedule and the successful interface with other public and private entities.

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37. Monitor, document, and report on the construction contractor's conformance with budget, cost, schedule, and overall performance of the work.
38. Oversee and monitor contract change requests, progress payments, schedule adjustments, completion, startup, and project acceptance are properly reviewed, evaluated, revised, approved, and implemented.
39. Provide oversight and reporting on significant contract changes to assure the best interests of DWR are maintained and contract requirements are enforced.
40. Assure project close-out procedures are planned, prepared, executed, documented, and completed for the successful training, startup, commissioning, and transfer of completed facilities to include inspection, preparation of completion certificates, receipt and review of contractor waivers, certifications, operations and maintenance data, as-built drawings and warranties, etc., and the preparation and execution of transfer documents.
41. The PM Contractor will lead the overall effort to foster and sustain a strong integrated team of assigned staff from DWR and the DHCCP Program Manager as well as staff from other agencies and contractors part of the DHCCP.
42. Establish and maintain a DHCCP office in Sacramento, California for staff from DWR and PM Contractor as well as staff from other agencies and contractors if required. Selection of location is subject to DWR approval.
43. Assist DWR in developing an overall program organizational structure to successfully implement the DHCCP within required timelines and budgets.
44. Implement continuous program improvement processes.
45. Assist DWR in maintaining a team spirit, cooperation between program participants, and good lines of communication.

POTENTIAL ADDITIONAL SERVICES:

DWR reserves the right to have the PM Contractor provide the following additional services. The PM Contractor could be required to provide support expertise in planning, environmental, engineering and construction, and other program management areas when requested. Other areas could include:

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1. Assist DWR with public information/public outreach efforts.
2. Program and/or project risk assessment.
3. Water resources and recreational planning.
4. Water rights specialist to support program work.
5. Safety management and oversight.
6. Real Estate services.

CONTACT INFORMATION:

The Authorized DWR and PM Contractor representatives during the term of this agreement will be:

Department of Water Resources

Representative: Richard Sanchez
1416 9th Street, Room 406-8
Sacramento, California 95814
Phone: (916) 653-3927
Fax: (916) 653-2467
Email: richs@water.ca.gov

Washington Division of URS Corporation

Representative: Joseph Ehasz
2870 Gateway Oaks Drive Suite 150
Sacramento, CA 95833
Phone: (916) 835-5200
Fax: (916) 679-2900
Email: Joseph.Ehasz@wgint.com

DOE's Contract Manager for all administrative purposes for this contract is Teresa Engstrom at (916) 653-1993 or tengstro@water.ca.gov. Contract Managers may be changed by written notice to the other party.

DISABLED VETERAN BUSINESS ENTERPRISE (DVBE) PROGRAM REQUIREMENTS

- A. The State of California's mandated DVBE Participation Program is an element of this contract and shall be included in all future contract amendments. DVBE program requirements may be required relevant to specific Task Orders and will be at the discretion of the Department to be determined on a Task Order-by-Task Order basis. Amendments to Task Orders with DVBE requirements shall also be subject to continued DVBE subcontracting requirements.
- B. DVBE Program Participation Goals of 3 percent have been set for this contract effort and will be the goal of each Task Order issued.

Exhibit 2

Contract No. 4600008104, Am. 1
Exhibit E, Attachment 6
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COVENANTS

Background:

Washington Group International, Inc., d/b/a Washington Division of URS Corporation ("URS—WD"), has been performing program management services and engineer support services for the Delta Habitat Conservation and Conveyance Program ("DHCCP") since May 2008 under Agreement No. 4600008104 ("the Agreement") with the California Department of Water Resources ("DWR"). The Agreement is administered by DWR's Department of Engineering ("DOE"). URS—WD must transition a new individual into the Program Manager role due to demands related to its current employee's career phase. DWR has directed URS—WD to engage Mr. Charles Gardner, president of Hallmark Group, Inc. ("Hallmark"), to fill the position of Program Manager by subcontracting with Hallmark for this purpose. Mr. Gardner will be providing general direction to URS—WD in coordination with DWR, while at the same time being subject to contractual obligations under a URS—WD subcontract with Hallmark, which will give URS—WD control of subcontract payments. To clarify the roles and responsibilities of the parties and subcontractor Hallmark, and in order to avoid the appearance of or any actual conflicts of interest that might arise from such an arrangement (the "Conflict"), the parties have agreed to amend the Agreement. The covenants set out below are for the purposes of preventing any actual or apparent conflicts from arising, and to permit work under the Agreement to proceed effectively. URS—WD agrees to subcontract with Hallmark for Mr. Gardner's services as Program Manager under the terms and conditions set forth in this Amendment.

Covenants:

1. Hallmark Subcontract.

- a. Upon agreement and execution by DWR and URS—WD of this Amendment, DWR will issue a Task Order which directs URS—WD to enter into a subcontract with Hallmark to provide the services of Mr. Gardner to function as the Program Manager on a full time basis as well as other Hallmark personnel as reasonably required to effectively perform the Program Manager function, all in accordance with the terms and conditions of this Amendment. URS—WD shall make good faith efforts to enter into such a subcontract (Subcontract) with Hallmark on terms and conditions reasonably acceptable to URS—WD.
- b. The Subcontract shall specify that Hallmark is an independent contractor and is not the agent or employee of DWR or URS—WD. Except as otherwise provided for in this Amendment, all other terms and conditions of the Subcontract shall be in accordance with the terms and conditions of the Agreement.

2. Hallmark Invoices.

- a. To maintain transparency in all matters related to the Conflict, DWR shall make the sole and final determination as to the payment to Hallmark of any and all amounts invoiced by Hallmark.
- b. The Subcontract will require Hallmark to submit each invoice for payment to URS-WD and to simultaneously send a copy directly to DOE's Contract Manager. Promptly upon receipt of the invoice, URS-WD shall submit an invoice to DWR consisting solely of the amount invoiced by Hallmark and with a copy of Hallmark's invoice attached. After receipt of the URS-WD invoice for Hallmark services, DWR shall provide written notice to URS-WD of those portions of Hallmark's invoice that are approved for payment, and the details and rationale for those portions of the invoice that are questioned or not approved for payment by DWR.
- c. The time period for payment of URS-WD's invoices for amounts invoiced by Hallmark shall start at the date received from URS-WD by DOE's Contract Manager. DWR will perform the review and approval function and provide the written notice that are specified in paragraph 2.b. of this Amendment, in accordance with the timelines stated in Exhibit B of the Agreement and subject to the Budget Contingency Clause of Exhibit B of the Agreement.
- d. Hallmark's right to payment for services performed under the subcontract between URS-WD and Hallmark, is subject to the prior approval by DWR of the invoices submitted by Hallmark to URS-WD. URS-WD shall make payment to Hallmark for any services rendered only to the extent that the invoice for those services has been approved by DWR. This condition precedent to payment of a URS-WD subcontractor under this Agreement shall be effective only as to Hallmark and not to any other subcontractor under this Agreement.
- e. Except as otherwise provided for in this section 2, the payment terms of the Subcontract shall be substantively the same as the payment terms of the Agreement.

3. Conflict of Interest.

- a. Each party shall promptly notify the other upon the discovery or realization of any actual or potential act or omission by any party, including Hallmark, against the interests arising from the Agreement, and the parties shall promptly implement all reasonable measures to eliminate or satisfactorily mitigate the conflict of interest and any actual or potential impact thereof. Such mitigating measures shall not extend to termination of URS-WD.

Contract No. 4600008104, Am. 1
Exhibit E, Attachment 6
Page 3 of 4

- b. Except to the extent URS-WD fails or refuses to follow the requirements of this Amendment or of any measures implemented pursuant to paragraph 3.a above, DWR and the State of California hereby waive any claim that URS-WD is in breach of the Agreement or is not entitled to compensation for services, due to any actual or apparent conflict of interest arising in any way out of or in connection with the circumstances described in the Background paragraph of this Amendment.

4. Hallmark Authority.

- a. Mr. Gardner will be reporting directly to and receive direction from DWR. Chief of DOE Richard Sanchez will remain DWR's signatory and authorized representative for purposes of the Agreement.
- b. Neither Mr. Gardner nor the Hallmark Group is authorized to make any binding commitment for or on behalf of DWR or URS-WD. By way of example and without limiting the generality of the foregoing, neither Mr. Gardner nor the Hallmark Group is authorized to do any of the following in connection with the Agreement or any other agreement to which DWR is a party: (i) approve or execute Task Orders, Task Order Amendments or Amendments to this Agreement; (ii) authorize or approve any increase or decrease in compensation; or (iii) authorize, approve or waive any deviation from any contractual requirements, including but not limited to, any change in scope of work or time of performance.
- c. Mr. Gardner is authorized to provide general direction to URS-WD on behalf of DWR, within the boundaries of the Agreement, by communicating and coordinating with URS-WD's Assistant Program Manager. Neither Mr. Gardner nor Hallmark are authorized to dictate the means or methods of URS-WD's personnel performing the work under the Agreement, but are authorized to communicate with, exchange information with and make such specific requests to such personnel that will, in their judgment, effectively coordinate DHCCP activities and contribute to achieving schedule milestones. URS-WD shall cooperate with Mr. Gardner in his role as Program Manager and shall promptly notify DWR of any issue or concern regarding direction received from or other interaction with Mr. Gardner.
- d. DWR shall notify and/or make arrangements with DWR's other DHCCP contractors that provides for Mr. Gardner to perform Program Manager authority with respect to their operations that is similar to the authority specified above with respect to URS-WD's operations.

5. Limitation of Liability and Indemnity.

- a. URS-WD's liability to DWR in any manner arising out of or in connection with any act, omission, negligence or any other aspect of Mr. Gardner's or Hallmark's performance that is the subject of this Amendment shall be strictly limited to whatever damages or other relief URS-WD actually obtains from Mr. Gardner or Hallmark. This limitation shall apply to claims in contract, tort (including negligence), indemnity, warranty or any other legal theory. This section 5 is a material provision of this Amendment. However, nothing in this section 5 shall relieve URS-WD from liability to the proportionate extent of URS-WD's own fault or negligence (excluding fault or negligence arising from a duty based on URS-WD's employment of Hallmark as a subcontractor, such as but not limited to failure to properly supervise a subcontractor or any claim based on a master-servant relationship, *respondent superior*, or breach of a non-delegable duty).
- b. DWR will defend and indemnify URS-WD against third party claims based on or concerning any actual or alleged conflict of interest arising out of or in connection with this Amendment or its implementation.

Exhibit 3

State of California

Department of Water Resources

The Resources Agency

Contract # 4600008104

Exhibit D

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**Special Terms and Conditions for
Department of Water Resources
(Over \$5,000 Standard Payable)**

1. **EXCISE TAX:** The State of California is exempt from Federal Excise Taxes, and no payment will be made for any taxes levied on employees' wages.
2. **RESOLUTION OF DISPUTES:** In the event of a dispute, Contractor shall file a "Notice of Dispute" with the Director or the Director's Designee within ten (10) days of discovery of the problem. The State and Contractor shall then attempt to negotiate a resolution of such claim and, if appropriate, process an amendment to implement the terms of any such resolution. If the State and Contractor are unable to resolve the dispute, the decision of the Director or the Director's Designee shall be final, unless appealed to a court of competent jurisdiction.

In the event of a dispute, the language contained within this agreement shall prevail over any other language including that of the bid proposal.



3. **PAYMENT RETENTION CLAUSE:** Ten Five percent of any progress payments that may be provided for under this contract shall be withheld per ~~Public Contract Code Section 10346~~ pending satisfactory completion of all services under the contract and paid on a quarterly basis after receipt of invoice for retention amount.
4. **AGENCY LIABILITY:** The Contractor warrants by execution of this Agreement, that no person or selling agency has been employed or retained to solicit or secure this Agreement upon agreement or understanding for a commission, percentage, brokerage, or contingent fee, excepting bona fide employees or bona fide established commercial or selling agencies maintained by the Contractor for the purpose of securing business. For breach or violation of this warranty, the State shall, in addition to other remedies provided by law, have the right to annul this Agreement without liability, paying only for the value of the work actually performed, or otherwise recover the full amount of such commission, percentage, brokerage, or contingent fee.
5. **POTENTIAL SUBCONTRACTORS:** Nothing contained in this Agreement or otherwise shall create any contractual relation between the State and any subcontractors, and no subcontract shall relieve the Contractor of its responsibilities and obligations hereunder. The Contractor agrees to be as fully responsible to the State for the acts and omissions of its subcontractors and of persons either directly or indirectly employed by any of them as it is for the acts and omissions of persons directly employed by the Contractor. The Contractor's obligation to pay its subcontractors is an independent obligation from the State's obligation to make payments to the Contractor. As a result, the State shall have no obligation to pay or enforce the payment of any moneys to any subcontractor.
6. **SUBCONTRACTING:** The Contractor is responsible for any work it subcontracts. Subcontracts must include all applicable terms and conditions of this Agreement. Any subcontractors, outside associates, or consultants required by the Contractor in connection with the services covered by this Agreement shall be limited to such individuals or firms as were specifically identified in the bid or agreed to during negotiations for this Agreement, or as are specifically authorized by the Contract Manager during the performance of this Agreement. Any substitutions in, or additions to, such subcontractors, associates or consultants shall be subject to the prior written approval of the Contract Manager. Contractor warrants, represents and agrees that it and its subcontractors, employees and representatives shall at all times comply with all applicable laws, codes, rules and regulations in the performance of this Agreement. Should State determine that the work performed by a subcontractor is substantially unsatisfactory and is not in substantial accordance with the contract terms and conditions, or that the

Contract # 4600008104

Exhibit D

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7. RENEWAL OF CCC: Contractor shall renew the Contractor Certification Clauses or successor documents every three (3) years or as changes occur, whichever occurs sooner.
8. REPORT OF RECYCLED CONTENT CERTIFICATION: In accordance with Public Contract Code Sections 12200, 12205, 12209, and 12156(e), the contractor will complete and return the form DWR 9557, Recycled Content Certification, for each required product to the Department at the conclusion of services specified in this contract. Form DWR 9557 is attached to this Exhibit and made part of this contract by this reference.
9. TERMINATION CLAUSE: The State may terminate this contract without cause upon 30 days advance written notice. The Contractor shall be reimbursed for all reasonable expenses incurred up to the date of termination.
10. COMPUTER SOFTWARE: For contracts in which software usage is an essential element of performance under this Agreement, the Contractor certifies that it has appropriate systems and controls in place to ensure that state funds will not be used in the performance of this contract for the acquisition, operation or maintenance of computer software in violation of copyright laws.
11. PRIORITY HIRING CONSIDERATIONS: For contracts, other than consulting services contracts, in excess of \$200,000, the Contractor shall give priority consideration in filling vacancies in positions funded by the contract to qualified recipients of aid under Welfare and Institutions Code Section 11200 (Public Contract Code Section 10353).
12. EQUIPMENT RENTAL AGREEMENTS: This provision shall apply to equipment rental agreements. The State shall not be responsible for loss or damage to the rented equipment arising from causes beyond the control of the State. The State's responsibility for repairs and liability for damage or loss to such equipment is restricted to that made necessary or resulting from the negligent act or omission of the State or its officers, employees, or agents.
13. CONFLICT OF INTEREST:
 - a. Current and Former State Employees: Contractor should be aware of the following provisions regarding current or former state employees. If Contractor has any questions on the status of any person rendering services or involved with the Agreement, the awarding agency must be contacted immediately for clarification.
 - (1) Current State Employees: (PCC §10410)
 - (a) No officer or employee shall engage in any employment, activity or enterprise from which the officer or employee receives compensation or has a financial interest and which is sponsored or funded by any state agency, unless the employment, activity or enterprise is required as a condition of regular state employment.
 - (b) No officer or employee shall contract on his or her own behalf as an independent contractor with any state agency to provide goods or services.
 - (2) Former State Employees: (PCC §10411)
 - (a) For the two-year period from the date he or she left state employment, no former state officer or employee may enter into a contract in which he or she engaged in any of the negotiations, transactions, planning, arrangements or any part of the decision-making process relevant to the contract while employed in any capacity by any state agency.

- (b) For the twelve-month period from the date he or she left state employment, no former state officer or employee may enter into a contract with any state agency if he or she was employed by that state agency in a policy-making position in the same general subject area as the proposed contract within the 12-month period prior to his or her leaving state service.

b. Penalty for Violation:

- (a) If the Contractor violates any provisions of above paragraphs, such action by Contractor shall render this Agreement void. (PCC §10420)

c. Members of Boards and Commissions:

- (a) Members of boards and commissions are exempt from this section if they do not receive payment other than payment of each meeting of the board or commission, payment for preparatory time and payment for per diem. (PCC §10430 (e))

d. Representational Conflicts of Interest:

The Contractor must disclose to the DWR Program Manager any activities by contractor or subcontractor personnel involving representation of parties, or provision of consultation services to parties, who are adversarial to DWR. DWR may immediately terminate this contract if the contractor fails to disclose the information required by this section. DWR may immediately terminate this contract if any conflicts of interest cannot be reconciled with the performance of services under this contract.

e. Financial Interest in Contracts:

Contractor should also be aware of the following provisions of Government Code §1090:

"Members of the Legislature, state, county district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members. Nor shall state, county, district, judicial district, and city officers or employees be purchasers at any sale or vendors at any purchase made by them in their official capacity."

f. Prohibition for Consulting Services Contracts:

For consulting services contracts (see PCC §10335.5), the Contractor and any subcontractors (except for subcontractors who provide services amounting to 10 percent or less of the contract price) may not submit a bid/SOQ, or be awarded a contract, for the provision of services, procurement of goods or supplies or any other related action which is required, suggested, or otherwise deemed appropriate in the end product of such a consulting services contract (see PCC §10365.5).

Exhibit 4

GTC 307

EXHIBIT C

GENERAL TERMS AND CONDITIONS

1. APPROVAL: This Agreement is of no force or effect until signed by both parties and approved by the Department of General Services, if required. Contractor may not commence performance until such approval has been obtained.

2. AMENDMENT: No amendment or variation of the terms of this Agreement shall be valid unless made in writing, signed by the parties and approved as required. No oral understanding or Agreement not incorporated in the Agreement is binding on any of the parties. *This term is subject to the provisions of Exhibit A, Item K.*

3. ASSIGNMENT: This Agreement is not assignable by the Contractor, either in whole or in part, without the consent of the State in the form of a formal written amendment.

4. AUDIT: Contractor agrees that the awarding department, the Department of General Services, the Bureau of State Audits, or their designated representative shall have the right to review and to copy any records and supporting documentation pertaining to the performance of this Agreement. Contractor agrees to maintain such records for possible audit for a minimum of three (3) years after final payment, unless a longer period of records retention is stipulated. Contractor agrees to allow the auditor(s) access to such records during normal business hours and to allow interviews of any employees who might reasonably have information related to such records. Further, Contractor agrees to include a similar right of the State to audit records and interview staff in any subcontract related to performance of this Agreement. (Gov. Code §8546.7, Pub. Contract Code §10115 et seq., CCR Title 2, Section 1896).

5. INDEMNIFICATION: *To the extent of the Contractor's negligent errors or omissions or willful misconduct*, Contractor agrees to indemnify, defend and save harmless the State, its officers, agents and employees from any and all claims and losses accruing or resulting to any and all contractors, subcontractors, suppliers, laborers, and any other person, firm or corporation furnishing or supplying work services, materials, or supplies in connection with the performance of this Agreement, and from any and all claims and losses accruing or resulting to any person, firm or corporation who may be injured or damaged by Contractor in the performance of this Agreement.

6. DISPUTES: Contractor shall continue with the responsibilities under this Agreement during any dispute.

7. TERMINATION FOR CAUSE: The State may terminate this Agreement and be relieved of any payments should the Contractor fail to perform the requirements of this Agreement at the time and in the manner herein provided. In the event of such termination the State may proceed with the work in any manner deemed proper by the State. All costs to the State shall be deducted from any sum due the Contractor under this Agreement and the balance, if any, shall be paid to the Contractor upon demand.

Contract # 4600008104

Exhibit C

Page 2 of 4

8. INDEPENDENT CONTRACTOR: Contractor, and the agents and employees of Contractor, in the performance of this Agreement, shall act in an independent capacity and not as officers or employees or agents of the State.

9. RECYCLING CERTIFICATION: The Contractor shall certify in writing under penalty of perjury, the minimum, if not exact, percentage of post consumer material as defined in the Public Contract Code Section 12200, in products, materials, goods, or supplies offered or sold to the State regardless of whether the product meets the requirements of Public Contract Code Section 12209. With respect to printer or duplication cartridges that comply with the requirements of Section 12156(e), the certification required by this subdivision shall specify that the cartridges so comply (Pub. Contract Code §12205).

10. NON-DISCRIMINATION CLAUSE: During the performance of this Agreement, Contractor and its subcontractors shall not unlawfully discriminate, harass, or allow harassment against any employee or applicant for employment because of sex, race, color, ancestry, religious creed, national origin, physical disability (including HIV and AIDS), mental disability, medical condition (cancer), age (over 40), marital status, and denial of family care leave. Contractor and subcontractors shall insure that the evaluation and treatment of their employees and applicants for employment are free from such discrimination and harassment. Contractor and subcontractors shall comply with the provisions of the Fair Employment and Housing Act (Gov. Code §12990 (a-f) et seq.) and the applicable regulations promulgated thereunder (California Code of Regulations, Title 2, Section 7285 et seq.). The applicable regulations of the Fair Employment and Housing Commission implementing Government Code Section 12990 (a-f), set forth in Chapter 5 of Division 4 of Title 2 of the California Code of Regulations, are incorporated into this Agreement by reference and made a part hereof as if set forth in full. Contractor and its subcontractors shall give written notice of their obligations under this clause to labor organizations with which they have a collective bargaining or other Agreement.

Contractor shall include the nondiscrimination and compliance provisions of this clause in all subcontracts to perform work under the Agreement.

11. CERTIFICATION CLAUSES: The CONTRACTOR CERTIFICATION CLAUSES contained in the document CCC 307 are hereby incorporated by reference and made a part of this Agreement by this reference as if attached hereto.

12. TIMELINESS: Time is of the essence in this Agreement.

13. COMPENSATION: The consideration to be paid Contractor, as provided herein, shall be in compensation for all of Contractor's expenses incurred in the performance hereof, including travel, per diem, and taxes, unless otherwise expressly so provided.

14. GOVERNING LAW: This contract is governed by and shall be interpreted in accordance with the laws of the State of California.

15. ANTITRUST CLAIMS: The Contractor by signing this agreement hereby certifies that if these services or goods are obtained by means of a competitive bid, the Contractor shall comply with the requirements of the Government Codes Sections set out below.

a. The Government Code Chapter on Antitrust claims contains the following definitions:

1). "Public purchase" means a purchase by means of competitive bids of goods, services, or materials by the State or any of its political subdivisions or public agencies on whose behalf the Attorney General may bring an action pursuant to subdivision (c) of Section 16750 of the Business and Professions Code.

2). "Public purchasing body" means the State or the subdivision or agency making a public purchase. Government Code Section 4550.

b. In submitting a bid to a public purchasing body, the bidder offers and agrees that if the bid is accepted, it will assign to the purchasing body all rights, title, and interest in and to all causes of action it may have under Section 4 of the Clayton Act (15 U.S.C. Sec. 15) or under the Cartwright Act (Chapter 2 (commencing with Section 16700) of Part 2 of Division 7 of the Business and Professions Code), arising from purchases of goods, materials, or services by the bidder for sale to the purchasing body pursuant to the bid. Such assignment shall be made and become effective at the time the purchasing body tenders final payment to the bidder. Government Code Section 4552.

c. If an awarding body or public purchasing body receives, either through judgment or settlement, a monetary recovery for a cause of action assigned under this chapter, the assignor shall be entitled to receive reimbursement for actual legal costs incurred and may, upon demand, recover from the public body any portion of the recovery, including treble damages, attributable to overcharges that were paid by the assignor but were not paid by the public body as part of the bid price, less the expenses incurred in obtaining that portion of the recovery. Government Code Section 4553.

d. Upon demand in writing by the assignor, the assignee shall, within one year from such demand, reassign the cause of action assigned under this part if the assignor has been or may have been injured by the violation of law for which the cause of action arose and (a) the assignee has not been injured thereby, or (b) the assignee declines to file a court action for the cause of action. See Government Code Section 4554.

16. CHILD SUPPORT COMPLIANCE ACT: "For any Agreement in excess of \$100,000, the contractor acknowledges in accordance with Public Contract Code 7110, that:

a). The contractor recognizes the importance of child and family support obligations and shall fully comply with all applicable state and federal laws relating to child and family support enforcement, including, but not limited to, disclosure of information and compliance with earnings assignment orders, as provided in Chapter 8 (commencing with section 5200) of Part 5 of Division 9 of the Family Code; and

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Exhibit C

Page 4 of 4

b) The contractor, to the best of its knowledge is fully complying with the earnings assignment orders of all employees and is providing the names of all new employees to the New Hire Registry maintained by the California Employment Development Department.”

17. UNENFORCEABLE PROVISION: In the event that any provision of this Agreement is unenforceable or held to be unenforceable, then the parties agree that all other provisions of this Agreement have force and effect and shall not be affected thereby.

18. PRIORITY HIRING CONSIDERATIONS: If this Contract includes services in excess of \$200,000, the Contractor shall give priority consideration in filling vacancies in positions funded by the Contract to qualified recipients of aid under Welfare and Institutions Code Section 11200 in accordance with Pub. Contract Code §10353.

Exhibit 5

AGREEMENT SUMMARY
STD 215 (Rev 4/2002)

AGREEMENT NUMBER	AMENDMENT NUMBER
4600008104	5

CHECK HERE IF ADDITIONAL PAGES ARE ATTACHED

1. CONTRACTOR'S NAME URS Energy & Construction, Inc.		2. FEDERAL I.D. NUMBER 34-0217470
3. AGENCY TRANSMITTING AGREEMENT Department of Water Resources	4. DIVISION, BUREAU, OR OTHER UNIT Division of Engineering	5. AGENCY BILLING CODE 81000
6. NAME AND TELEPHONE NUMBER OF CONTRACT ANALYST FOR QUESTIONS REGARDING THIS AGREEMENT		

7. HAS YOUR AGENCY CONTRACTED FOR THESE SERVICES BEFORE?
 NO YES (If YES, enter prior contractor name and Agreement Number)

8. BRIEF DESCRIPTION OF SERVICES - LIMIT 72 CHARACTERS INCLUDING PUNCTUATION AND SPACES
 Amend to add money, new subcontractor, and additional Task Order template

9. AGREEMENT OUTLINE (Include reason for Agreement: Identify specific problem, administrative requirement, program need or other circumstances making the Agreement necessary; include special or unusual terms and conditions.)

See Std. 215, Page 3 of 4

10. PAYMENT TERMS (More than one may apply.)

MONTHLY FLAT RATE QUARTERLY ONE-TIME PAYMENT PROGRESS PAYMENT

ITEMIZED INVOICE WITHHOLD _____ % ADVANCED PAYMENT NOT TO EXCEED _____ %

REIMBURSEMENT/REVENUE \$ _____ or _____ %

OTHER (Explain) No more often than monthly, in arrears

FUND TITLE	ITEM	F.Y.	CHAPTER	STATUTE	PROJECTED EXPENDITURES
WRRF	3860-902-0691	12/13	186/86	Sec. 135 WC	\$10,000,000.00
					\$
OBJECT CODE Unknown / GL Acct 9032640200				AGREEMENT TOTAL	\$ 70,000,000.00
OPTIONAL USE Contract Manager: Allan Davis (916) 952-2779				AMOUNT ENCUMBERED BY THIS DOCUMENT	
				\$ 10,000,000.00	
I CERTIFY upon my own personal knowledge that the budgeted funds for the current budget year are available for the period and purpose of the expenditure stated above.				PRIOR AMOUNT ENCUMBERED FOR THIS AGREEMENT	
				\$ 60,000,000.00	
ACCOUNTING OFFICER'S SIGNATURE			DATE SIGNED	TOTAL AMOUNT ENCUMBERED TO DATE	
See attached funding strip				\$ 70,000,000.00	

AGREEMENT	TERM		TOTAL COST OF THIS TRANSACTION	BID, SOLE SOURCE, EXEMPT
	From	Through		
Original	5/27/08	12/31/15	\$ 60,000,000.00	RFQ
Amendment No. 1	5/27/08	12/31/15	\$ 0.00	Exempt - add personnel
Amendment No. 2	5/27/08	12/31/15	\$ 0.00	Exempt - add personnel
Amendment No. 3	5/27/08	12/31/15	\$ 0.00	Exempt - add personnel and testing rates
Amendment No. 4	5/27/08	12/31/15	\$ 0.00	Exempt - add personnel and rates
Amendment No. 5	5/27/08	12/31/15	\$ 10,000,000.00	Exempt - add subcontractor
	TOTAL		\$ 70,000,000.00	

(Continue)

October 2017

STATE OF CALIFORNIA
AGREEMENT SUMMARY
 STD. 215 (Rev 4/2002)

13. BIDDING METHOD USED:

REQUEST FOR PROPOSAL (RFP) INVITATION FOR BID (IFB) USE OF MASTER SERVICE AGREEMENT
(Attach justification if secondary method is used)

SOLE SOURCE CONTRACT EXEMPT FROM BIDDING OTHER *(Explain)* 23CCR387 and GC 4525 et seq.
(Attach STD. 821) *(Give authority for exempt status)*

NOTE: Proof of advertisement in the State Contracts Register or an approved form STD. 821, Contract Advertising Exemption Request, must be attached

14. SUMMARY OF BIDS *(list of bidders, bid amount and small business status) (If an amendment, sole source, or exempt, leave blank)*
 N/A - Amendment

15. IF AWARD OF AGREEMENT IS TO OTHER THAN THE LOWER BIDDER, PLEASE EXPLAIN REASON(S) *(If an amendment, sole source, or exempt, leave blank)*
 N/A - Amendment

16. WHAT IS THE BASIS FOR DETERMINING THAT THE PRICE OR RATE IS REASONABLE?

See Std. 215, page 4 of 4

17. JUSTIFICATION FOR CONTRACTING OUT *(Check one)*

Contracting out is based on cost savings per Government Code 19130(a). The State Personnel Board has been so notified.
Justification:

Contracting out is justified based on Government Code 19130(b) Justification for the Agreement is described below.

N/A - RFQ pursuant to Government Code Section 4525 et seq/

18. FOR AGREEMENTS IN EXCESS OF \$5,000, HAS THE LETTING OF THE AGREEMENT BEEN REPORTED TO THE DEPARTMENT OF FAIR EMPLOYMENT AND HOUSING? <input type="checkbox"/> NO <input checked="" type="checkbox"/> YES <input type="checkbox"/> N/A	19. HAVE CONFLICT OF INTEREST ISSUES BEEN IDENTIFIED AND RESOLVED AS REQUIRED BY THE STATE CONTRACT MANUAL SECTION 7.10? <input type="checkbox"/> NO <input checked="" type="checkbox"/> YES <input type="checkbox"/> N/A	20. FOR CONSULTING AGREEMENTS, DID YOU REVIEW ANY CONTRACTOR EVALUATIONS ON FILE WITH THE DGS LEGAL OFFICE? <input type="checkbox"/> NO <input type="checkbox"/> YES <input type="checkbox"/> NONE ON FILE <input checked="" type="checkbox"/> N/A
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21. IS A SIGNED COPY OF THE FOLLOWING ON FILE AT YOUR AGENCY FOR THIS CONTRACTOR? A. CONTRACTOR CERTIFICATION CLAUSES B. STD. 204, VENDOR DATA RECORD <input type="checkbox"/> NO <input checked="" type="checkbox"/> YES <input type="checkbox"/> N/A <input type="checkbox"/> NO <input checked="" type="checkbox"/> YES <input type="checkbox"/> N/A	22. REQUIRED RESOLUTIONS ARE ATTACHED <input type="checkbox"/> NO <input type="checkbox"/> YES <input checked="" type="checkbox"/> N/A
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23. ARE DISABLED VETERANS BUSINESS ENTERPRISE GOALS REQUIRED? *(If an amendment, explain changes, if any)*

NO *(Explain below)* YES *(If YES complete the following)*

DISABLED VETERAN BUSINESS ENTERPRISES: 3 % OF AGREEMENT

- Good faith effort documentation attached if 3% goal is not reached.
- We have determined that the contractor has made a sincere good faith effort to meet the goal.

Explain:

Exemption from DVBE participation (#35) was approved on March 19, 2008. DVBE Program requirements will be applied on a Task Order basis for this contract.

24. IS THIS A SMALL BUSINESS CERTIFIED BY OSBCR?
 NO YES *(Indicate Industry Group)*


SMALL BUSINESS REFERENCE NUMBER

25. IS THIS AGREEMENT (WITH AMENDMENTS) FOR A PERIOD OF TIME LONGER THAN ONE YEAR? *(If YES, provide justification)*

NO YES

The DHCCP - when finalized - will provide essential environmental restoration and water supply to California. This multi-year contract provides the engineering support services and program management services that will assist in the DHCCP completion. In order for the DHCCP to be successful, continual engineering support services and program management services need to be in place; therefore, this multi-year contract is in the best interest of the state.

I certify that all copies of the referenced Agreement will conform to the original Agreement sent to the Department of General Services.

SIGNATURE/TITLE 	TITLE Richard Sanchez, Chief	DATE SIGNED 10/11/17
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Contract No. 4600008104, Am. 5

Std. 215

Page 3 of 4

9. AGREEMENT OUTLINE

The purpose of this Amendment is to add ten million dollars to the contract and add the firm McKinsey & Company as a subcontractor. Additionally, this Contract Amendment provides for the development of governance and organizational structures for the DHCCP using Deliverables Paid Task Orders (DPTO). The DHCCP has been delayed due to issues related to completing the public draft of the EIR/EIS. Furthermore, the DHCCP organizational structure is very cumbersome and has left a need for additional program management support in the form of new subcontractor. Additional funds are needed to insure that the program management effort remains at the current levels through the completion of the environmental documentation preparation phase and for the new subcontractor to develop the DHCCP governance and organizational structure.

The DHCCP has progressed to a phase where the organizational structure and governance have become increasingly critical to the future success for design and construction of the project. Since January of 2012 attempts have been made to create a governance structure that addresses the issues of organization, governance, decision rights, and project implementation. These efforts had limited success and were costly in terms of real dollars and lost productivity. It was requested by the DHCCP Business Committee that highly specialized consultants be retained and tasked with resolving these fundamental issues.

Bringing on McKinsey & Company to be a subcontractor to Hallmark will allow for the successful completion of the governance and organizational structure of the DHCCP. Two phases as DPTO may be initiated under this contract. Phase one will provide the development of the DHCCP governance options, and phase two will contain the decision rights and implementation. DPTO will be used in order to better meet the governance and organizational needs for this contract as well. URS will not be legally responsible for McKinsey's work product. DWR releases URS Energy & Construction, Inc. from any claims for any loss, liability, or damages arising out of or in connection with any act omission, negligence or any other aspect of McKinsey & Company's performance and Hallmark Group Inc.'s performance under the McKinsey DPTO, regardless of the legal theory under which the claim is made. DWR will defend and indemnify URS Energy & Construction, Inc. against any claims from any party other than DWR arising out of or in connection with the performance of McKinsey & Company and Hallmark Group Inc. under the McKinsey DPTO.

Due to the limited success of the extensive effort that has already taken place, and the diverse nature of the stakeholders, it is not practical to estimate the number of consultant hours that will be required. The structure of the contract, fixed fee based on deliverables, is beneficial to both DWR and the stakeholders that will ultimately pay the costs for this consultant, since the consultant is only authorized to bill the fixed price for deliverables that have been accepted and approved, as opposed to hourly labor each month.

This Amendment is also updating Exhibit E, Attachment 1 - Travel and Per Diem Expenses.

16. WHAT IS THE BASIS FOR DETERMINING THAT THE PRICE OR RATE IS RESONABLE?

This Contract Amendment adds the ability to do Deliverable Paid Task Orders (DPTO) for the development of governance and organizational structures of the DHCCP only. Each DPTO will be independently reviewed and a fair and reasonable price will be determined for each deliverable. Ten million dollars total will be added to the Contract through this Amendment. Two million six hundred thousand dollars of the money being added to the Contract will be specifically assigned to DPTOs. The remaining amount of the funding is to insure that the program management effort stays at the current levels through the completion of the environmental documentation preparation phase.

Services provided by McKinsey & Company through DPTOs – also called “McKinsey DPTOs” – will not exceed \$2,691,000. This Contracts’ DPTOs will not exceed \$2,691,000. Two phases will break-up the \$2,691,000 and are listed below. The DWR Contract Manager will determine if Phase II is necessary.

- a. Phase I - Developing DHCCP Governance Options: \$1,345,500 (which includes the 3.5% mark-up to URS Energy & Construction, Inc.)
- b. Phase II - Decision Rights and Implementation: \$1,345,500 (which includes the 3.5% mark-up to URS Energy & Construction, Inc.)

Since January of 2012 attempts have been made by DWR Management, DWR DHCCP Program Manager, and State Water Project contractors to create a governance structure that addresses the issues of organization, governance, decision rights, and project implementation. For the last nine (9) months, these efforts produced limited success and were costly in terms of real dollars and lost productivity to the DHCCP Program. Due to the unique and immensely important nature of the DHCCP governance structure, the price negotiated for McKinsey is fair and reasonable because McKinsey will be able to finalize a governance structure for the DHCCP that addresses the issues above by using a Deliverables Paid Task Order method where payment is dependent on deliverables completed.

The non-DPTO funding will be billed using the rate schedule originally negotiated per Exhibit B, Attachment 1 or original Contract. The originally negotiated rates were deemed fair and reasonable after comparing them to existing contracts for similar services. No hourly rates are being changed or added by this Contract Amendment.

COMMENTS

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM DWR

To provide clarity and perspective, we are commenting on DWRs' response to our audit. The numbers below correspond to the numbers we have placed in the margin of DWR's response.

While preparing our draft report for publication, some page numbers shifted. Therefore, the page numbers DWR cites in its response do not correspond to the page numbers in our final report.

DWR incorrectly asserts that all activities for the planning of the project were paid for by the public water agencies. In Figure 5 on page 15 we show that \$81.2 million of the funding for the conservation and conveyance program, or 31 percent—the largest portion of funding—came from the U.S. Bureau of Reclamation.

We stand by our conclusion that DWR did not follow state law in selecting the program manager. As described on pages 25 through 29, and in exhibit 2 in DWR's response on page 69, it directed URS to "subcontract" with the president of Hallmark without demonstrating DWR assessed his qualifications, including that he was a licensed engineer. The purported "subcontract" created operational inefficiencies that led DWR to eventually award Hallmark a direct contract through an assignment.

We address the issues in this summary in the "Findings" section of DWR's response.

Although DWR states that it received excellent value from Hallmark, the fact remains that the current program manager that DWR directed URS to hire as a subcontractor does not possess the qualifications DWR sought when it initially awarded the contract to URS. Furthermore, as we state on page 29, the cost of Hallmark's contract increased from \$4.1 million to \$13.8 million.

We disagree that the project was conceived as just an engineering enterprise. DWR's request for qualifications and its contract with URS included more than just engineering; they also required program management services for which URS initially identified an individual as its program manager. DWR's statement seems to indicate that URS' program manager did not have the management expertise requisite for the scale and complexity of the project. However, that statement contradicts the letter we reviewed that DWR sent to URS disapproving the program manager. As we

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state on page 24, DWR replaced the URS program manager apparently because he was not working full-time on the project, not because he lacked the necessary expertise.

- ⑦ DWR mischaracterizes the services for which Hallmark was “subcontracted.” DWR and the former director attempt to narrowly define the responsibilities of Hallmark, when, in fact, the “subcontract” made Hallmark responsible for the entire scope of work for program management services. Further, the description of Hallmark’s role provided by the former director was based on assertions that neither he nor DWR was able to support. In addition, nowhere in DWR’s exhibit 2 contract language directing URS to subcontract with Hallmark’s president to fill the position of program manager, or in the scope of work in DWR’s exhibit 1—its agreement with URS describing the tasks it expected the project manager to perform—does it specify that Hallmark or its president was hired exclusively to provide cost control as DWR claims. For example, as stated in item 7 of exhibit 1 appearing on page 63, Hallmark was also responsible for coordinating, overseeing, and monitoring other contractors including, but not limited to, environmental, engineering and construction services.
- ⑧ DWR states that Hallmark was hired to provide its “proven management skills.” However, DWR was unable to demonstrate that it assessed Hallmark’s qualifications. As we state on page 25, our review of DWR’s contract file for Hallmark found no evidence that DWR evaluated Hallmark’s qualifications for the program manager role.
- ⑨ It is unclear to us what budget projection DWR is referring to. As we state on page 20, in 2012 DWR signed agreements with water contractors for an additional \$100 million—a 71 percent increase to the initial \$140 million budget—to fund the remaining planning phase activities. Additionally, as we also state on page 20, DWR ultimately exhausted this \$100 million augmentation and had to contribute \$15 million in surplus revenues in 2015 and 2016 along with an extra \$6.8 million contribution from Reclamation and the Authority to fund additional planning costs.
- ⑩ We do not misunderstand the contract. Although we agree that the scope of work included multiple elements, one of the main elements was construction project management services, which include services like those included in exhibit 1 on pages 59 and 60 in DWR’s response and many of the deliverables listed on pages 62 through 66. By law these services must be performed by a licensed architect, registered engineer, or licensed general contractor; and DWR’s request for qualifications required the program manager to have a professional engineering license.

While we do not dispute that subcontracting is permitted, as we explain on pages 27 and 28, and as shown in exhibit 2 in DWR’s response on pages 69 through 72, the arrangement DWR created was not a true contractor-subcontractor arrangement. Specifically, URS was not overseeing Hallmark’s work products, it was not determining payment to Hallmark, and it was not legally responsible for Hallmark’s work. Additionally, we expected DWR to require URS to provide an equally qualified replacement program manager or for DWR to have used a competitive process to select a replacement program manager. Finally, because the program management services DWR was seeking included construction project management, state law requires the program manager to be a licensed architect, registered engineer, or licensed general contractor.

⑪

DWR describes in its response the inherent conflict the unusual arrangement created, and the contract terms it had to include to protect against this precarious situation. As we describe on page 28, DWR also eventually changed this arrangement to address the inefficient workflow that resulted from the subcontract. Furthermore, the asserted success of the arrangement does not justify the manner in which DWR procured Hallmark’s services as program manager.

⑫

Our report does not narrowly focus on the request for qualifications process. On pages 24 and 25 we state that because of the size, cost, complexity, and significance to the State of WaterFix, we expected DWR to have required URS to provide an equally qualified replacement program manager. Because DWR included a requirement in its request for qualifications that the program manager work full-time on the project it is unclear to us why DWR did not enforce this requirement, but instead directed URS to “subcontract” with Hallmark who lacked some of these qualifications. By requiring URS to provide a qualified program manager who is able to work full-time on the project, as required by the request for qualifications, DWR would have avoided the 5-month delay it asserts would have occurred if it had used a competitive process to replace its program manager.

⑬

Despite DWR’s assertion, the “subcontract” makes it clear that Hallmark is the firm responsible for the entire scope of program management services. The “subcontract” did not identify any overlap between Hallmark and URS in the work of the program management services to be provided by Hallmark that would suggest a “team” approach. In fact, in DWR’s exhibit 2 on page 69 directing URS to subcontract with Hallmark and its president specifies that “Hallmark is an independent contractor and is not the agent or employee of DWR or URS”.

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- ⑮ We stand by our conclusion. As described on page 27 and 28, the relationship established between URS and Hallmark was not truly a “subcontract,” and Hallmark did not have the required qualifications or license to provide the services. Further, assigning the work, although provided for by the contract, avoids the competitive process that is favored in state contracting law. In addition, by assigning the contract to Hallmark, DWR contradicts its earlier assertion that it used a team approach for program management. Finally, Hallmark and URS do not operate as a team if URS is no longer a party to the contract for program management services.
- ⑯ As we state on pages 28 and 29, when we asked for its rationale, DWR told us that the assignment provided its staff direct access to Hallmark while saving the 5 percent markup URS charged under the subcontract. However, we question this reasoning because DWR created the difficulties in the first place, and we are not convinced DWR is saving money because Hallmark has had to subcontract many of its program management functions and DWR is generally paying a 5 percent markup for invoices from these subcontractors.
- ⑰ DWR has not provided evidence describing how the fee was established or that it was fair and reasonable with price comparisons or a market survey. As we state on page 30, DWR did not justify adequately the \$2.69 million cost. Further, on page 30 we also explain that DWR staff raised the same concern because the justification from Hallmark simply stated that the price “is worth it because McKinsey has such a great track record,” which we do not consider to be adequate assurance the price was fair and reasonable.
- ⑱ Contrary to DWR’s assertion, our report does not imply that no governance structure exists or that a lack of such a structure is contrary to legal requirements. Our report on pages 34 and 35 states that DWR has not fully implemented a governance structure for the design and construction phase of WaterFix. In addition, we conclude that it is essential that DWR develop an appropriate governance structure so that it is prepared to oversee the design and construction of WaterFix in the event the project is ultimately approved. This conclusion parallels DWR’s perspective as shown in exhibit 5 on page 85 of the contract amendment that added \$10 million dollars to the contract and added McKinsey as a subcontractor. The amendment language states that the “conservation and conveyance program has progressed to a phase where the organizational structure and governance have become increasingly critical to the future success for design and construction of the project.” This section is to inform the reader that the governance structure for which DWR paid \$2.69 million has not been fully implemented.

DWR misunderstands the report. We do not suggest that DWR must assess each water agency's needs and provide a final financial analysis before the decision to opt into WaterFix is made. On pages 34 and 35 we include the statement from DWR officials that the final financial analysis report cannot be prepared until the contractors desiring to participate in WaterFix are identified. We also include on page 35 DWR officials' statement that its contractor, Public Finance Management, modeled a wide range of financing options for WaterFix that were shared with water contractor boards. Finally, these officials stated that once individual agencies decide to participate, the financing will be tailored to meet each agency's needs.

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We disagree that the documents DWR has maintained serve the same planning function as the program management plan. As the text box on page 36 shows, the management plan includes staffing requirements, reporting relationships, and participant roles and responsibilities, among other things. Additionally, the management plan incorporates that information together in one cohesive document. Our review of Aconex found a document repository (essentially a digital filing cabinet) with numerous, disparate, historical and current documents that DWR staff had to pour through in an effort to locate something that was responsive to our request for the management plan.

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Our recommendation does not presuppose that time delays have a negative consequence, rather that they should be thoroughly justified and vetted. The recommendation does not limit DWR's ability to be responsive to stakeholder input, but would require DWR to consciously and transparently consider that input before making decisions that affect project cost and schedule, whether during planning or other phases of the project.

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We disagree with DWR's revision to the recommendation because it introduces the risk that DWR will direct contractors to select specific subcontractors, which undermines the intent of the recommendation to have the contractor put forth the subcontractor it believes will best perform the work required by the contract and require DWR to verify the qualifications of the subcontractor before approving the selection.

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