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Critics Raising Concerns About Cadiz Water Project

Resources: The stakes are high--financially and politically--for the Santa Monica company and its proposed partner, the Metropolitan Water District.

May 19, 2002 | MICHAEL A. HILTZIK | TIMES STAFF WRITER

CADIZ, Calif. — Sometime in the next few weeks, a federal agency is expected to issue the final environmental approval necessary to turn this former Mojave Desert railroad outpost into a billion-dollar water development project.

As the culmination of a laborious five-year environmental review, that ruling from the Interior Department's Bureau of Land Management would represent a milestone for the project and for its sponsor, Cadiz Inc. The politically well-connected company, which has been growing grapes and citrus fruits on a patchwork of money-losing irrigated tracts across the San Joaquin and Coachella valleys sees the Mojave project as the linchpin of its plan to transform itself into a global water development enterprise.

The stakes are high. The project to store trillions of gallons of Colorado River water in the sands beneath Cadiz's 27,000-acre tract could earn the company about \$500 million in fees over the next 50 years. Cadiz hopes it also will give it a foothold in a prospective boom market for water in California and other parched regions around the world. As a token of its ambitions, the company this year named former Interior Secretary Bruce Babbitt to head a new subsidiary to pursue similar water deals in the Middle East.

The Mojave project also is of great importance to Cadiz's proposed partner, the giant Metropolitan Water District of Southern California. The project would be one of the most complex and costly undertaken by the MWD. Such a financial partnership with a private corporation would be unique in the district's history.

Under tentative contract terms approved a year ago by the MWD board, the district and Cadiz would split the \$150-million construction cost of the project, which involves pumping water through a 35-mile pipeline connecting the MWD's Colorado River Aqueduct and the Mojave storage site. There it would be banked underground and, along with existing supply from an aquifer underlying the tract, pumped back to the aqueduct as an emergency supply during droughts.

As the MWD's 37-member board prepares to take a final vote on the project, possibly this summer, some of the agency's directors are questioning whether the massive investment makes financial sense, and whether a partnership with Cadiz is appropriate for a public water district.

These questions also arise because Cadiz lacks experience building or managing a water project of this scale. The company would play no role in managing construction or operating project once it is

completed. That would be the responsibility of the MWD, which would foot the \$1-million annual bill for operation and maintenance.

Cadiz's ability to meet its financial obligations also is open to question. The company, whose chairman and chief executive, Keith Brackpool, once pleaded guilty to criminal charges relating to securities trading and later was forced to resign an executive post because of his outside business dealings, has never turned an annual profit. Its total losses from 1993 through 2001 come to more than \$105 million.

At year-end 2001 its debt of \$141.5 million--much of it carrying high junk-bond interest rates--dwarfed its shareholder equity of \$17.7 million. That debt includes a \$35-million credit line from ING Barings that Cadiz has renewed periodically as a source of working capital until the water project begins generating revenue. The implicit cost of that loan will start to rise if Cadiz fails to repay it by the end of July.

An Abundance of Political Connections

Significantly, the source of much of Cadiz's initial \$75-million capital contribution to its partnership with the MWD would be the water district itself.

Under the negotiated terms, on the day the final contract is signed the MWD would front Cadiz more than \$54 million in "prepayment" for 195 billion gallons of water storage. How much of that money would be available to pay for construction is unclear: In January, as a condition of extending its \$35-million loan for an additional year, ING Barings inserted a provision requiring that the loan be repaid from money Cadiz receives from the MWD for the project's construction.

"If its lenders make a claim on our \$54 million, how does the project get built?" asked Peer Swan, an MWD board member representing the Orange County Municipal Water District. "Cadiz is not the strongest player. What guarantee is there if it goes bankrupt?"

What the company does have in abundance are political connections. Former Rep. Tony Coelho, an important Democratic Party fund-raiser, serves on the Cadiz board. The Democratic pedigree of the newly hired Babbitt extends from his 10 years as Arizona governor in the 1970s and '80s to his service in the Clinton Cabinet.

But by far the company's leading political contact is Gov. Gray Davis, who has named Brackpool to at least two statewide advisory panels on water resources.

Despite the company's consistent losses and the British-born Brackpool's ineligibility to vote, Cadiz and its CEO have been among Davis' leading financial contributors since 1998. Records show that the company and Brackpool contributed \$134,000 to Davis' 1998 gubernatorial campaign, part of the \$415,000 in total donations they made to candidates statewide. From 1999 through 2001, the company contributed an additional \$101,187 to Davis' reelection campaign.

Brackpool also has hosted numerous fund-raising events for Davis and other candidates, some of them at the Manhattan Country Club in Manhattan Beach, owned by a Brackpool partnership.

All this leads some MWD board members to speculate that district executives have placed the Cadiz project on the fast track--ahead of other, possibly worthier, programs--to placate Davis.

MWD officials deny that. "I've stated to the board that we're not interested in this project because of the participating company," MWD Chief Executive Ronald R. Gastelum said. "We're interested because of the potential asset and its location."

Brackpool, 44, labels concerns about Cadiz's financial stability as "ridiculous" and the product of "ludicrous unfounded allegations."

"Time and time and time again we have raised the money for this project," the entrepreneur said in a recent interview at the company's Santa Monica headquarters. "We have withstood a five-year process.... This company has always raised every penny it said it was going to raise."

He said the company plans to restructure its balance sheet soon by merging its agricultural subsidiary with a company run by the wealthy Saudi Prince Alwaleed bin Talal ibn Abdulaziz al Saud, a transaction designed to provide Cadiz with an equity infusion of as much as \$80 million. (The merger has not been completed, however, and Brackpool told investors two weeks ago that it has run into some regulatory snags overseas.)

Brackpool also dismisses charges that political influence has played a role in the MWD's consideration of the project. "I don't think any work that I've done for the governor or any relationship that I've had with the governor has been relevant to the project at all," he said. "The state has nothing to do with this project. There is no state regulatory involvement in this project."

It is unclear whether opponents of Cadiz can muster enough votes on the MWD board to kill or defer the project. Several board members, including representatives of the powerful Los Angeles Department of Water and Power, have expressed strong support for the project. Others who have expressed reservations also have said they would keep an open mind.

Still, skepticism on the MWD board runs high. "If we had a new governor," said James Edwards, an MWD board member representing the Foothill Municipal Water District, "I believe this thing would fall by the wayside and die a natural death."

The Cadiz project first bubbled to the surface in the mid-1990s, when the MWD was laboring under crises on several fronts.

First came the water crisis. Neighboring states and the federal government were insisting that California take steps to live within its statutory allocation of 4.4 million acre-feet of water a year from the Colorado River. The state had consistently exceeded this figure, largely by exploiting water left unused by neighboring Arizona and Nevada. After those growing states started consuming their full

allocations, California relied on the Department of the Interior to drain extra water from Lake Mead every year to meet the state's unslaked thirst.

No one considered this a long-term solution, however. California eventually agreed to bring demand into line with its legal allocation by 2015, at which point the surplus supplies would cease.

The implications of the reduction were particularly dire for the MWD, which received 550,000 acre-feet of the state's allocation (about 180 trillion gallons, or enough to serve 1.1 million families for a year) but customarily consumed an additional 400,000 or more. The district hastily began drawing up a list of conservation programs, new supply sources and storage projects to meet its new constraints.

Meanwhile, a political crisis simmered over the MWD's incessant squabbling with neighboring water agencies about various issues relating to the Colorado River supply. Politicians, including Davis, were quick to weigh in.

"Gov. Davis had nothing but disdain for the Met," recalled Francesca Krauel, a San Diego lawyer then serving on the MWD board. The MWD feared that an angry governor might move abruptly to end its decades of proud independence.

Cadiz glimmered as a multifaceted solution to all these issues. By stockpiling Colorado River water under the Cadiz sands in years when a surplus is available, the MWD could offset shortages in dry years and after surpluses are no longer available. A partnership with Cadiz would prove that the district was able to reach an innovative deal with a private entity at a time American private enterprise was lionized as the most efficient in the world.

"There was so much criticism of the Met as a monopoly, with people asking if anyone could do a deal in which the Met doesn't control," said John R. Wodraska, MWD general manager in the mid-1990s. "The Met had an incentive to show it could do a public-private partnership."

Company's Focus Shifted to Selling Water

That Brackpool was a friend of the governor was implicitly seen as a plus. It was true that the MWD was not a state agency, but Davis' authority over statewide water matters made him a dangerous nemesis.

"The thinking was: You make a deal with Keith Brackpool, and you're on the good side of Gray Davis," Krauel said.

Cadiz, as it happens, had its roots not in large-scale water development, but in a plan to use aerial-mapping technology to find underground water resources and use them to grow crops in the desert. Brackpool, initially brought into the plan in 1983 as an investment banker, stayed to help turn it into a business.

Over the next 10 years, he and his partners assembled several sizable tracts in the Mojave largely by buying up old railroad concessions. In time the company's focus shifted from farming to selling water.

By the early 1990s, Brackpool had concluded that high labor costs and harsh regulation had placed "California agriculture ... in terminal decline," as he put it in a recent interview with The Times, by allowing Mexican growers to nibble away at its lucrative markets. About the same time, he said, "the whole Colorado River issue was really becoming important and I thought, 'This is going to get really interesting.'" Cadiz still owned water rights.

Ups and Downs of Brackpool's Career

Brackpool soon acquired a reputation around the state as a visionary with a no-nonsense platform of aggressive action on water policy. "How would Southern California ever be able to attract new capital investment," he said, "if every year you had to wait to find out whether the secretary of the Interior cut your water supply off or not? It was certainly no way to manage the future of the largest and fastest-growing part of the state."

Brackpool spoke with the elan of an innovative, successful businessman. But his career had had its ups and downs.

In 1983, for example, he pleaded guilty in London to criminal charges that included dealing in securities without a license. The charges involved Nishco Portfolio Management, an investment firm of which he was part-owner and which, among other things, handled offshore investments for wealthy Kenyans. Brackpool, who paid a fine of \$3,200, later referred to the charges as the equivalent of misdemeanors. A spokesman for the London City Fraud Squad, which brought the charges, said the agency no longer had records of the case, which would have been shredded by 1990.

Then in 1991, Brackpool was forced to resign his post as chief executive in North America for Albert Fisher Group, a highflying British food company whose chairman had hand-picked him for the job. The resignation was the direct result of Brackpool's personal dealings with Polly Peck, a British conglomerate that had imploded in a spectacular accounting scandal resembling the Enron Corp. affair.

Although he was an executive of Albert Fisher and Polly Peck was a direct competitor, Brackpool personally guaranteed a \$10-million loan Polly Peck made to him and several partners to enable them to buy out a Polly Peck subsidiary. When Polly Peck collapsed, its receivers demanded the money and the arrangement came to light.

Brackpool's involvement undermined the credibility of Fisher's chairman, Tony Millar, who lost his job soon after Brackpool's departure.

Brackpool said he voluntarily resigned to devote time to settling the Polly Peck claim. He also insisted that the transaction was a legitimate business deal undermined by the unexpected crisis at Polly Peck. "No one thought when we went into it that Polly Peck would go bust," he said. Eventually, Brackpool said, he and the receivers of Polly Peck settled all outstanding claims.

Little of this background was widely known in the U.S. when Brackpool brought his water storage proposal to the MWD in 1997, nor is it widely known today.

In any event, Wodraska said, MWD officials harbored doubts about Cadiz's finances almost from the start.

"The question about Cadiz always was the economics," he said. "Cadiz Inc.'s long-term viability was always a concern."

The project also ran into stiff opposition from environmentalists, who questioned Cadiz's claim that as much as 30,000 acre-feet a year could be extracted from an aquifer under its parcel. (Cadiz would charge the MWD more than twice as much for this "indigenous" water than it would for the storage component.) Experts from the U.S. Geological Survey contended that the figure was closer to 3,000 acre-feet, based on what it computed is the rate at which the water is naturally replenished.

The discrepancy was important because extracting too much water could expose the aquifer to environmental contamination from neighboring brine deposits.

The disagreement was never resolved; instead it was finessed by an agreement to install a network of monitoring wells around the tract to detect early signs of contamination, and to cease the extraction if they appear.

But MWD officials have worked hard to resolve the financial issues raised by Cadiz's fiscal condition. Gastelum said the final contract to be presented to the MWD and Cadiz boards will insulate the district's assets from the company's fortunes.

Among other things, it will give the district veto power over all of Cadiz's financing terms, such as any that might expose the district's contribution to the claims of existing creditors. The project would have to be operated by a new subsidiary fenced off from most of Cadiz's existing liabilities. (Such an arrangement would require the approval of Cadiz's existing creditors.) The negotiated terms also call for the district to gain ownership of the land and construction if Cadiz defaults on its obligations.

"If they were to disappear, the Met would essentially get the project," said MWD general counsel Jeffrey Kightlinger.

MWD officials say working with Cadiz does have its pluses. For one thing, the company has shown remarkable staying power by surviving years of litigation and environmental scrutiny while better-heeled private investors have bailed out of similar water projects. And because many of the MWD's other proposed water supply programs may die because of political or environmental challenges, the advanced stage this one has reached adds to its value.

Still, some water experts and board members say it is not too late to reexamine the project and its financial terms. Although Brackpool has long intimated that the Cadiz project is all but indispensable to Southern California's water future, that's no longer an unchallenged view at the Los Angeles headquarters of the MWD.

District officials say their goal is to build about 3 million acre-feet of storage capacity that can provide 300,000 to 400,000 acre-feet a year to the Colorado River Aqueduct in a dry year. Any more than that

might be wasted, as the aqueduct's total capacity is only 1.25 million acre-feet and other sources could help keep it filled.

MWD Considering Large-Scale Storage

Of five separate projects under consideration, Cadiz included, the district would need to complete only two or three to reach that goal. The MWD's \$67-million Hayfield project, which is on MWD-owned land adjacent to the aqueduct near its eastern end, already is operating and eventually could provide up to half the needed storage and transmission capacity.

The MWD also may have to reconsider moving ahead with plans for large-scale storage, which would require years of a reliable supply of surplus water from the Colorado River. The federal government recently threatened to cut off the surplus next year out of irritation with California's lagging water planning. If that happens, said the MWD's Gastelum, the district probably would put all storage programs on indefinite hold.

Brackpool, for his part, continues to exude confidence that the Cadiz project will win approval from the MWD board and will be profitable for both sides.

As the price of water rises, he told investors in a conference call two weeks ago, the MWD will view its contracted cost of water from Cadiz as "very advantageous." Continuing droughts in the Midwest, environmental challenges to alternative California projects and rising demand for water will only make the Cadiz program seem more promising as time goes on.

"We just continue to see the fundamentals moving absolutely in the direction we want," he said.

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