

QSA Q&A

February 16, 2010

1. How much will the appeal cost?

The estimated expense to IID of seeking a stay from the appellate court by way of a writ proceeding and an appeal of Judge Candee's decision is about \$400,000-700,000, depending on the scope of issues raised by all the parties on appeal.

2. How much does stoppage of the QSA cost IID?

If the QSA "stops" as a result of a determination by Judge Candee that some of the QSA agreements are invalid, and IID (or another QSA party) does not appeal and obtain a stay of judgment, then IID would lose significant net revenues and incur substantial additional expenses and liabilities.

For example, in 2010 alone, IID would not have to pay about \$1.4 million for payments to the Salton Restoration Fund and the QSA JPA; but IID would lose approximately \$28 million in water transfer revenues, plus an additional \$50 million dollar lump-sum transfer revenue payment. Further, in 2010, IID would likely have to pay approximately \$5.5 million on active following contracts, and other funds for water conservation activities (to create conserved water that may never be transferred or otherwise utilized). In addition, in 2010, IID will still have to pay \$5.2 million on 2000 and 2004 certificates of participation that were obtained to finance necessary QSA activity.

In 2010, without the QSA, unless IID steps forward and, acting alone, takes on the full funding responsibility for environmental activities, which is in the millions of dollars, IID will lose the protection of QSA environmental actions (paid in part by other agencies under the QSA), which, among other things, provide environmental coverage to permit Water Department operation and maintenance as well as environmental protection to Imperial Valley landowners. If the QSA environmental coverage is lost, IID will be required to expend significant funds, in the millions of dollars, to obtain alternative environmental protection.

In 2010, IID will be exposed to an award for attorneys' fees to prevailing parties in the QSA coordinated cases (concerning issues which IID believes, if it appealed, it could overturn on appeal and thus avoid such an award).

In 2010, IID will expend additional attorneys' fee, to sort out disputes between the state, federal government, QSA agencies, and other entities concerning the effect of partial invalidation of the agreement and inconstant governmental and legal mandates. Further, IID will likely spend significant fees on lawyers and experts to defend it from reasonable and beneficial water use challenges that will certainly arise if the QSA is no longer in place.

3. Does IID support the QSA in its present form?

IID's position is that the district, its water users and the Imperial Valley are better served – and better protected – with the QSA in place than without it. The existing agreement offers the most viable framework and least financial exposure to the district in reaching accord on the Salton Sea mitigation question.

What IID wants is the agreement it thought it had, which includes protection from future reasonable and beneficial consumptive use challenges and a cap on impacts caused by the water transfer to the Salton Sea. If the district can obtain more than that from direct talks with the state and the other QSA parties, it will obviously work toward that end, but it cannot accept less.

4. Is IID casting a wider net than Stuart Somach for a second opinion?

Attorney Stuart Somach presented his review of the QSA coordinated cases and the judge's decision on February 9, 2010. While his analysis was thorough and wide-ranging, the board may find, on a going-forward basis, that its needs are best met by drawing from a wider array of legal opinion.

Mr. Somach was asked to offer his advice and counsel on IID's planned notice of appeal and requested stay of the judge's ruling in the QSA coordinated cases, which he did, stating that by failing to take either action, the district would be placing itself in a position of weakness.

It is likely that, as the appellate process unfolds, he and others will be called on to assess the strength of the district's case.

5. Was the QSA a good contract for IID and the Imperial Valley?

When it was agreed to by the IID board in 2003, the QSA was considered the best agreement available at the time for the district, its water users and the people of the Imperial Valley. It provided certainty, protection from legal challenges over reasonable and beneficial consumptive use, a dedicated revenue stream to fund needed water conservation measures that would otherwise be paid for by IID customers and a cap on impacts caused by the transfer of water on the Salton Sea.

Six years later, the only thing that has changed is that 12 of the 35 contracts that comprise the QSA have been invalidated by a Sacramento Superior Court judge. All of the other conditions present in 2003, including the drought on the Colorado River system and the pressure for California to live within its annual entitlement of 4.4 million acre-feet, still exist. So, too, does the risk of a forced taking of an unknown quantity of the district's water for no compensation by the federal government, which holds that its contracts under the QSA remain valid.

Whether the QSA is as good as it could have been is no longer the operative question. Instead, it must be evaluated according to whether or not it is necessary to safeguard the Imperial Valley's water rights, and IID believes the only reasonable and responsible answer is yes.

6. What is plan B?

Plan B is already under way. It began when Sacramento Superior Court Judge Roland Candee invalidated 12 of the 35 contracts that make up the QSA, and it has been in effect ever since the IID board passed its resolution calling for, among other things, the preservation of not only its legal rights but also its options.

In that resolution, the board committed itself to a transparent process that "allows for public input and maintains the public's trust." The district has already held one public workshop to make clear its intentions regarding the filing of a notice of appeal and request of a stay in the QSA coordinated cases, but has also resolved to "pursue all available avenues" to address and remediate any real or perceived deficiencies in the agreement itself.

7. Did IID mislead the local court?

The Imperial County Superior Court was fully informed by the parties and not in any way misled. The parties had informed the Court that IID's validation action was limited to a specific identified list, that there were far more QSA contracts than the list that IID sought to validate, and that the Morgan action sought to invalidate more than the list IID sought to validate. Counsel for Morgan even used the IID/DWR contract as an example of a contract IID did not include.

The Imperial County Superior Court, after being fully informed, dismissed the Morgan reverse validation action. Judge Candee's conclusions that perhaps the Imperial County Superior Court was not fully informed by the parties or was misled is wrong, reflects a failure by Judge Candee to review the applicable Court record, and reflects Judge Candee's failure to pose this as a question to the parties at any time with a request for briefing or identification of the actual facts.

8. What is the parallel path mentioned in IID Resolution No. 2-2010?

IID will be appealing and seeking a stay of the judge's ruling in the QSA coordinated cases as a means of maintaining the status quo during the appellate process, but litigation is only one facet of its overall strategy. At the same time, the district will be entering into direct talks with other QSA parties, the state and federal government and Imperial County officials to clarify roles and responsibilities having to do with mitigation of the water transfer's impacts on the Salton Sea.

To quote from the above resolution, which was approved by the IID board on January 5, 2010, IID explicitly acknowledges that, "there can be no enduring settlement of longstanding disputes among Colorado River users within California without a credible resolution of the transfer mitigation question and impacts to the Salton Sea."

The district, in other words, has committed itself to working on multiple fronts to secure the water transfer agreement, and protections, it bargained for in 2003. Its goal isn't merely to litigate the Salton Sea mitigation question under the existing agreement, but to definitively address it.

9. Where does the \$50 million from SDCWA go?

The \$50 million lump-sum payment must be used to fund water conservation capital projects.

10. What is the risk, if any, from the QSA protections disappearing?

If the QSA were to unravel, the protections it affords the IID would cease to exist. In addition to the basic forbearance it provides the district on future legal challenges to its reasonable and beneficial consumptive use, IID would lose its revenue stream to fund needed system and on-farm conservation measures considered vital to protecting the Imperial Valley's water rights.

Not only that, but the QSA has enabled IID to develop nearly finalized habitat conservation and natural community conservation plans to mitigate the transfer's impacts on the Salton Sea and the district's drain and agricultural field forage habitats. Moreover, early-start habitat and air impact mitigation efforts already under way at the Salton Sea would be eliminated if the QSA were no longer in effect.

If any of the QSA protections listed above were to be removed, the risk to IID would be considerable. Remove all of them at once, and that risk is compounded exponentially.

11. Does the Energy Department subsidize the Water Department?

The energy and water functions at IID may be distinct from one another but they are also complementary. Although the Energy Department has an annual operating budget that is nearly four times the size of the Water Department's and its service area extends beyond the boundaries of the irrigation service territory, they do share a proportionate cost of the organization's centralized services, realize substantial economies of scale and have common rights-of-way in the Imperial Valley.

Those rights-of-way, it should be noted, were obtained by the district before 1936, when IID became a public power provider. The district does assess a falling water charge to its energy ratepayers in the Imperial and Coachella valleys that generates \$7.5 million a year for the Water Department, but this can hardly be considered a subsidy since a tangible good, hydroelectric power from the All-American Canal, is derived for the benefit of all.

This particular argument has been raised from time to time – including in the context of the QSA coordinated cases – by those who advocate the establishment of a separate water board to administer the Imperial Valley's water rights. IID's position has been that an elected board to oversee both functions is the best way to serve – and protect – the public's interest.

12. What are present perfected rights?

IID's holds rights to use Colorado River water that are longstanding and under both state and federal law. IID's basic water rights are derived from a series of water appropriations, which were all conveyed in 1916.

In 1931, IID and other entities entered into the Seven-Party Agreement, which sets out Colorado River apportionments and priorities. As a result of the Seven-Party Agreement, IID limited certain California appropriative water rights in quantity and priority to the apportionments and priorities contained in the Seven-Party Agreement. However, IID's 1932 delivery contract with the Secretary of Interior provides that IID still retained its other water rights to the Colorado.

The term "present perfected rights" first appeared in the 1922 Colorado River Compact, which apportions Colorado River water between the upper and lower basins. The Compact provides that "present perfected rights to the beneficial use of waters of the Colorado River system are unimpaired by this Compact."

The 1929 Boulder Canyon Project Act recognized and protected present protected rights by providing that “the dam and reservoir ... shall be used; second, for irrigation and domestic uses and satisfaction of Present Perfected Rights in pursuance of ... said Colorado River Compact” Under the Act, California’s 4.4 million AF of mainstream water was to be used to satisfy “any rights which existed on December 21, 1928.” Such “rights” included present perfected rights within IID’s state appropriative water rights.

The United States Supreme Court in Arizona v. California defined “perfected right” and “present perfected rights” in its 1964 Decree, but IID’s present perfected rights were not quantified until the Supreme Court issued a Supplemental Decree in 1979. That Supplemental Decree defined IID’s present perfected rights as a right to water:

“In annual quantities not to exceed (i) 2,600,000 acre-feet of diversions from the mainstream or (ii) the consumptive use required for irrigation of 424,145 acres and for the satisfaction of related uses, whichever of (i) or (ii) is less, with a priority date of 1901.”

IID’s present perfected rights are important because the Supreme Court Decree provides that in any year in which there is less than 7.5 million AF of mainstream water available for release for consumptive use in Arizona, California, and Nevada, the Secretary of the Interior shall first provide for the satisfaction of present perfected rights in the order of their priority dates without regard to state lines before imposing shortage cutbacks on other junior water right holders.

13. Who pays attorneys fees?

If this question asks who pays IID’s attorneys’ fees, those related to the QSA cases are essentially paid by the IID ratepayers, although a substantial portion of these fees have been reimbursed by insurance coverage.

If the question asks whether any of the parties that opposed validation of the QSA can recover attorneys’ fees; generally under California law, a party to a lawsuit can only recover attorneys’ fees from an adverse party if that party is considered a prevailing party, the fees sought are reasonable, and such recovery is specifically provided for in a contract or law. In the QSA cases, some parties will argue that they are entitled to recover attorneys’ fees from opposing parties under certain legal theories. Depending on what legal theory the attorneys’ fees are sought, there will be various elements that the party seeking a fee award must establish in order to obtain an award of attorneys’ fees. IID, as well as

other entities that litigated in support of QSA validation, could be ordered to pay attorneys' fees.

14. Is Part 417 still part of the equation?

The concept of reasonable beneficial use is a very important limitation on the exercise of a water right and a foundational principle of western water law. Part 417 is a federal regulation under which the federal government may make reasonable and beneficial use determinations as to recipients of water under Colorado River water delivery contracts.

On December 27, 2002, in an effort to force IID to enter into the QSA, the Secretary of the Interior informed IID that, if the QSA was not executed by the end of 2002, then IID's 2003 water order would be cut by 241,100 AF. After no QSA was approved December 31, 2002, the secretary cut IID's water supply. IID immediately sued the secretary to stop the water reduction and obtained a preliminary injunction in court. However, the court allowed the secretary to perform a Part 417 beneficial use review of IID's water order. As a result of the Part 417 process, in 2003 IID's 3.1 MAF water order was reduced to 2,835,500 AF. IID disputed the Secretary's legal right to order the cutback under Part 417.

Under the QSA, adopted in October 2003, the Part 417 proceedings against IID were terminated and IID's full water order for 2003 was approved. Under one of the QSA agreements, the Department of Interior provided to IID reasonable assurance that, as long as the QSA is ongoing, deliveries to IID will not exceed that reasonably required for beneficial use, such that future Part 417 reviews of IID will not be necessary. If the QSA is deemed invalid, Interior would no longer be constrained by this assurance. The dispute over Part 417 will likely be renewed.

15. How much money has been spent on the QSA?

The QSA is designed so that, over the life of project, all costs of the QSA are provided for through transfer and JPA revenues, and that revenues will exceed project costs. Over the life of the QSA, the revenues are anticipated to exceed the costs in order to provide a reasonable cushion for any unforeseen circumstances.

For the years 2003 through 2008, IID QSA revenues exceeded costs by \$4.3 million. The accounting for 2009 has yet to be finalized; however, total net revenues have currently been raised to \$13 million. These net revenues shall be used to design and implement QSA efficiency conservation programs.

Since the QSA was executed in 2003, IID has published annual reports in both hard copy and on its Web site. These annual reports contain an explanation of all QSA related activities. The reports provide a wealth of data, including detailed accountings of QSA revenues and expenses. The reports also address all aspects of water accounting (use, transfer, storage, IOPP, fallowing, mitigation, conservation, and diversion) and financial accounting (environmental, Local Entity, transfer revenue and expense, Western Farms Land, AAC lining and legal fees). These reports can be obtained at IID or found at <http://www.iid.com/Water/QSAAnnualReports>. In addition, monthly QSA financials reports can be found at <http://www.iid.com/Water/Financial>.

16. IID has said that the QSA is far from perfect: How is it imperfect?

There were two accommodations made in the course of drafting the QSA that were controversial at the time they were made and remain so today.

The first was to allow the Coachella Valley Water District, which is next in line based on the Colorado River's priority system and was threatening to block the water-sharing pact from going forward unless it were included, into the transfer agreement for an additional 100,000 acre-feet a year. The second was to adopt fallowing as the primary method of generating water for the transfer during the first 15 years of the deal to mitigate its effects on the Salton Sea.

Fallowing was expressly prohibited in the original water transfer agreement signed by IID and the San Diego County Water Authority in 1998. The district favored efficiency-based conservation measures then, as it does now, but it accepted the bitter pill of fallowing because the alternative, a summary taking of water by the federal government, was considered too grave a risk for the IID and its water users to assume.

In signing the QSA, IID made a calculated decision to choose compromise over chaos. The concessions it agreed to were not insignificant, to be sure, but they did enable the district to provide its water users with safety and certainty, the value of which can only be fully appreciated if they are no longer in place.