

II. Summary of Agreement

The Agreement between the IID and the Authority², addresses the following subjects: conditions, transfer mechanism, quantity, term and renewal, pricing, and shortage sharing.

Four major conditions must be satisfied before the Agreement becomes effective:

First, environmental review must be completed. The IID is designated as the Lead Agency for environmental compliance under CEQA. The IID intends to work in close coordination with the federal lead agency designated for purposes of compliance under NEPA. Article 9 of the Agreement requires the IID and the Authority to complete the environmental review and assessment required by CEQA and NEPA. The transfer of conserved water to the Authority is expressly contingent upon a determination by the IID and the Authority to proceed with implementation of the activities described in the Agreement, which determination will be made only after completion of such environmental assessment and incorporation of any project alternatives and/or mitigation measures which those agencies consider appropriate or which are legally required by any other state or federal agency. The IID is responsible for the mitigation of any environmental impacts of water conservation efforts within Imperial County (excluding the Colorado River between Imperial Dam and the northern county border) and upon the Salton Sea, except that the IID has the right to terminate the Agreement in lieu of implementing such mitigation measures if the present value of projected mitigation expenditures might exceed \$15 million at the time of completion of environmental review. Once water transfers commence, if the present value of the cost to IID of original mitigation obligations and unanticipated environmental consequences combined exceed \$30 million, the IID may void the Agreement and terminate any further transfer of conserved water. The Authority is responsible for the mitigation of any environmental impacts on the Colorado River between Imperial Dam and Lake Havasu, resulting from the transportation of the conserved water from Imperial Dam to the Authority and for any impacts in San Diego County. The Authority has the right to terminate the Agreement in lieu of implementing such mitigation measures if the estimated mitigation costs exceed \$1 million at the time of completion of environmental review or \$2 million after transfers commence. Each party has a right, but no obligation, to contribute money to pay the other party's costs that exceed the specified limits--in which case, the Agreement would not be terminated. Further detail regarding environmental considerations is provided in Section VIII.

Second, the Authority must obtain, from the MWD or otherwise, the ability to wheel the amount of conserved water through the MWD's Colorado River Aqueduct ("CRA") to San Diego County. The Agreement specifies a formula for the base wheeling rate based on the amortized capital costs, O&M, replacement costs, and net power costs for the CRA facilities actually used to convey the water. The Agreement also provides that the Authority pay a "supplemental wheeling rate" to the MWD when the wheeling of the conserved water would prevent the MWD from diverting all the flood control releases available to the MWD pursuant to the reservoir operating criteria specified in the 1984 Field Working Agreement between the U.S. Army Corps of Engineers and the BOR. The supplemental wheeling rate may not exceed \$60 per AF. If the wheeling condition is not satisfied, either party may void the Agreement. As with the environmental condition, both parties have a right, but no obligation, to contribute money to pay the other party's share of wheeling costs that exceed the limits--in which case, the Agreement would not be terminated.

Third, the Agreement must receive necessary approvals from the SWRCB and BOR. SWRCB approval must include findings that: (1) §§ 1011, 1012 and 1013 apply to and govern the transfer; (2) the conserved water retains the same priority as if it were diverted and used by the IID; (3) the IID's water rights are unaffected by the transfer; (4) the transfer is in furtherance of earlier SWRCB decisions and orders concerning the IID's reasonable and beneficial water use, Article X, § 2 of the California Constitution and §§ 100 and 109 ; (5) the water conservation will be verified

by the IID reducing its diversions from the Colorado River in the amount of conserved water transferred, and (6) junior right holders will be protected during the term of the Agreement. BOR approval must find: (1) the transfer is consistent with federal law; (2) the BOR will account for the conserved water under the decree as part of the IID's net diversions under the IID's priority for use of Colorado River water; (3) the IID's water rights are unaffected by the transfer; (4) recognition of the SWRCB findings concerning the IID's reasonable and beneficial use of water and SWRCB verification of conserved water, which includes forbearance by the IID of its priority 3 water right at 3.1 million AF during the term of the Agreement; and (5) diversion of the conserved water by the Authority at Lake Havasu is permissible. Fourth, within 18 months of April 29, 1998, the IID must enter into conditional subscriptions of interest with landowners desirous of participating in on-farm conservation, expressly conditioned on the IID's compliance with environmental laws pursuant to Article 9 of the Agreement. Within 120 days of the IID's certification of the EIR, participating landowners must enter into contracts which commit the landowners to collectively conserve at least 130,000 AFY. The Agreement specifically provides that the contracts with participating landowners will prohibit following as a water conservation method. Subject to the terms and conditions of the Agreement, the IID may undertake and agrees to contract with landowners to undertake water conservation efforts and divert less Colorado River water by an amount equal to the conserved water created. The transfer occurs by the IID leaving water in the Colorado River in the amount of conserved water created for the Authority to divert and deliver to its service area. The Authority pays the IID for the quantity of water so transferred.

Water will be conserved and transferred pursuant to §§ 1011 and 1012 . The conserved water will retain the senior priority of the IID's water rights. There are two transfer schedules: the primary transfer and a discretionary additional transfer. The primary transfer quantity will commence only after the satisfaction of all four conditions discussed above. The quantity transferred in the first year will be 20,000 AFY, increasing each year by 20,000 AF until a "stabilized primary quantity" (e.g., maximum annual primary transfer) is reached. That quantity is between 130,000 AFY and 200,000 AFY, as determined by the IID in its complete discretion.

A discretionary additional transfer of up to 100,000 AFY may occur, but no sooner than the start of the 11th year. The quantity of the discretionary additional transfer is conditioned upon an IID determination of availability and an Authority determination of need. The discretionary additional transfer is further conditioned by the ability of the IID to include some or all of the additional available water in transfers to settle disputes with the MWD or the Coachella Valley Water District ("CVWD"). The IID may enter into agreements with the CVWD on any terms and conditions acceptable to IID, provided the CVWD covenants not to transfer the water received, directly or indirectly, for use outside the CVWD's jurisdictional boundaries. The IID may enter into agreements with the MWD, provided that either: (1) the MWD permanently waives all existing legal disputes related to the approval conditions under the Agreement, or (2) the MWD pays a price equal to or greater than the price the Authority pays during the same year. The amount of additional water potentially available to the Authority is up to 100,000 AFY, less any amount transferred to the MWD or the CVWD.

During the period of the potential availability of discretionary additional transfers, the IID and the Authority have a mutual right of first refusal. The IID has an exclusion for transfers to the MWD and the CVWD. The Authority has an exclusion for purchases from the MWD and for transfers with other third parties for water quality purposes and drought transactions. The Agreement includes a number of specific criteria for these transactions and limits on the quantity and duration of such transactions.

The Agreement has an initial term of 45 years. Subject to a material change provision concerning the continued ability and terms for the cost of conveying the conserved water through the CRA, each party has a unilateral option to renew the Agreement for a single renewal term of 30 years. At the renewal, the IID may recapture up to 34,000 AFY, provided that the IID's 1988 Agreement

with the MWD has expired or terminated. The Agreement also includes a meet and confer obligation for the parties to negotiate a potential extension of the Agreement after the end of the renewal term on any terms and conditions acceptable to the parties. At termination of the Agreement, the Authority has no claim to any further conserved water. The Agreement has three pricing provisions: base contract price, shortage premium, and price redetermination. The pricing under the Agreement starts with the base contract price and shortage premium.

The base contract price is determined by a series of formulae which depend on actual MWD rates and charges, the concept of a "base wheeling rate," and the actual wheeling rate for conveying the conserved water through the MWD's CRA to San Diego:

$$\text{Base Contract Price} = (\text{MWD Full Water Rate} - \text{Base Wheeling Rate}) \times (1 - \text{Discount}) + 50\% (\text{Base Wheeling Rate} - \text{Actual Wheeling Rate})$$

The formula for the MWD Full Water Rate is: MWD Full Water Rate = MWD Rate for untreated noninterruptible water service + per acre-foot valuation of other MWD rates and charges that vary with volume + other MWD rates and charges that do not vary with volume ÷ 4-year running average of the Authority purchases from MWD and IID. Certain MWD charges are excluded from the MWD Full Water Rate, including currently assessed property taxes.

The actual wheeling rate equals the base wheeling rate plus a "supplemental wheeling rate" specified in the transportation conditions of the Agreement. The discount starts at 25% in the first year, declines to 15% by the 10th year, and declines to its long-term value of 5% by the 17th year. Here are some sample calculations of the base contract price when the supplemental wheeling rate is not paid:

<i>Assumptions of Sample Calculation</i>	<i>Base Contract Price</i>
Year 1: initial projections of Full MWD Water Rate (\$400 per AF) and Base Wheeling Rate (\$68.50 per AF)	\$249 per AF
Year 10: initial projections of full water and base wheeling rates	\$282 per AF
\$10 per AF increase in base wheeling rate	\$273 per AF
\$10 per AF increase in MWD untreated water rate	\$290 per AF

In years when the Authority pays the "supplemental wheeling rate," the base contract price declines by 50% of the supplemental wheeling rate.

The Authority will make an additional "shortage premium" payment over the base contract price when there are significant shortfalls in California water supplies. The payment is made when any one of these three conditions exist:

- Northern California experiences a critical year condition;

- The Secretary of the Interior declares a shortage in the Lower Colorado River Basin; or
- The Authority imposes mandatory rationing or conservation

If the Authority does not impose mandatory rationing or conservation, then the Authority pays a shortage premium equal to 5% if Northern California experiences a critical year condition, 25% for a declared shortage in the Lower Colorado River Basin, or 30% if both conditions prevail. If the Authority does impose mandatory rationing or conservation, then the Authority pays the maximum of the above amount or the premium specified in the table below.

Authority Shortage	Premium
5% to <10%	10%
10% to <15%	15%
15% to <20%	30%
20% to <25%	40%
25% to <30%	50%
≥ 30%	100%

A price redetermination process will adjust the base contract price and the shortage premium to assure that the pricing provisions reflect the market value of IID water. The adjustments will be based on financial valuations of other transactions that meet a defined set of eligibility criteria. The market value of IID water will be estimated by adjusting the valuations of the other transactions to reflect differences between the IID/Authority transaction and the other transactions (such as supply reliability, water quality, and the time the other transactions were negotiated relative to the date of the price redetermination). The first price redetermination can be no sooner than 10 years after the start of the transfer of conserved water, provided that there are at least 10 transactions meeting the eligibility criteria and the volume in the California market exceeds 240,000 AFY. Thereafter, price redeterminations would generally occur no sooner than every 10 years; however, if a previous redetermination were based on fewer than 15 transactions, the next redetermination could be accelerated once information from more than 20 eligible transactions becomes available.

The pricing provisions of the Agreement are adjusted when a financial valuation of the existing pricing provisions is not consistent with the estimated market value of IID water under the redetermination process. The Agreement includes a defined quantitative criterion for making this determination. The new contract pricing provisions would be a weighted average of the existing price and the valuation of IID water estimated in the price redetermination. The weight given to the price redetermination grows with the scale of transactions in the California water market.

The IID and the Authority will share pro rata any reductions in water available to the IID under its priority 3 right when the Secretary of the Interior declares a shortage in the Lower Colorado River Basin. When the amount of water in usable storage in Lake Mead is less than 15 million AF and the unregulated inflow into Lake Powell is forecasted to be less than 8.8 million AF, the parties will also meet and confer to attempt to negotiate a supplemental water transfer agreement in anticipation of a shortage on the Colorado River of sufficient magnitude to reduce the availability of water to the IID under its senior water rights.

