



San Diego County Water Authority

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July 10, 2012

Jack Foley and Board Members
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

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Municipal Water District

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OTHER REPRESENTATIVE

County of San Diego

RE: IID Water Conservation and Related QSA Issues

Dear Mr. Foley:

We wanted to make sure that you and the other Metropolitan board members received a copy of Imperial Irrigation District's (IID) July 9, 2012 letter to Maureen Stapleton (copied to Mr. Kightlinger) in time for today's board meeting (Attachment 1). This letter describes the current status of the 2011 water conservation by IID: as of June 30, 2012, the full volume of 80,000 acre feet of water has been conserved. In addition, the letter describes the status of water conservation for 2012, including IID's projection that its fallowing program will generate over 180,000 acre feet of conserved water for transfer, mitigation and 2011 overrun payback purposes. While we appreciate that there are still accounting issues to be resolved by the Bureau of Reclamation, we hope this letter will put to rest some of the wild speculation by Metropolitan board members that the water transfer or QSA is at the "risk of collapse."

We have not yet received a response to Ms. Stapleton's June 27, 2012 letter to Mr. Kightlinger requesting a meeting with Metropolitan pursuant to Section 11.1 of the Exchange Agreement (Attachment 2) and it was not mentioned at yesterday's Water Planning and Stewardship Committee meeting (Committee). We look forward to receiving a response and to meeting with Metropolitan (and hopefully some of its board members) to address Metropolitan's concerns. As you know, we have suggested that IID and the Bureau of Reclamation be invited to attend the meeting in order to secure a resolution of the accounting issues – a resolution that the Water Authority fully supports. As you know, neither Metropolitan nor the Water Authority has any independent or unilateral authority to decide these questions.

Metropolitan board members requested at yesterday's Committee meeting that Metropolitan staff provide more detailed reporting on the status of the QSA and impacts on Metropolitan if it were to fail. We agree on both counts and that providing more detailed reports to the Metropolitan board would be helpful. Water Authority's past communications have noted that some comments by Metropolitan board members suggest the absence of an understanding that Metropolitan has a contractual obligation of good faith and fair dealing under the Exchange Agreement. Further, some comments reflect a lack of understanding that, but for the availability of this conserved water supply, Metropolitan's water shortage cutbacks (which ended only little more than one year ago) would have been greater. While it is admittedly a little late to begin this education process, we believe it would help put concerns of our fellow board members to rest

A public agency providing a safe and reliable water supply to the San Diego region

Mr. Foley and Board Members

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and that it is in any case, "better late than never."

Finally, to this same end, we are enclosing another copy of the letter from IID's attorneys to the Water Authority's attorneys dated May 1, 2012, providing additional background on the history and accounting issues now pending before the Bureau of Reclamation (Attachment 3). This letter was previously provided to all members of the Metropolitan board of directors along with several other attachments to Ms. Stapleton's June 27, 2012 letter – but may have been overlooked by some Metropolitan board members in the volume of material that was provided.

In closing, we were informed at yesterday's Committee meeting that, "we are right back in the drought we were in a few years ago" on the Colorado River. Accordingly, we reiterate the importance of all parties working together cooperatively to support water conservation by IID and the success of the QSA agreements – not just because Metropolitan is contractually bound to do so, but because it's the right thing to do in order to meet Southern California's water supply needs in the coming decades.

Finally, when staff brings back a report to the board as requested at yesterday's Committee meeting, we suggest that you include a full report on the negotiations that Metropolitan has fully participated in, along with the Bureau of Reclamation and the rest of the California parties, for an Alternative Plan to be presented to the State Water Resources Control Board in order to ensure the continued success and implementation of the QSA agreements. Having this kind of information may help put some of our fellow board members at ease.

Sincerely,



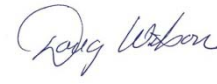
Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director



Doug Wilson
Director

cc: Maureen Stapleton
Jeff Kightlinger
T. Fulp, USBR
K. Kelley, IID
S. Robbins, CVWD
C. Harris, CRB
Water Authority Board of Directors

Attachments:

1. July 9, 2012 Letter from IID to SDCWA
2. June 27, 2012 Letter from SDCWA to MWD
3. May 1, 2012 Letter from IID Attorneys to SDCWA Attorneys



IID

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July 9, 2012

Maureen Stapleton, General Manager
San Diego County Water Authority
4677 Overland Ave.
San Diego, CA 92123

Dear Ms. Stapleton:

The San Diego County Water Authority has asked the Imperial Irrigation District for a short update regarding two issues: (1) the status of the 16,722 acre-feet IID conservation "shortfall" in 2011, which IID contends was an inadvertent overrun and (2) the approximate scope of the following sign-ups for the 2012-13 IID following program.

The provisional data for the 2011-12 IID following program were originally estimated at 30,134 acre-feet 'at-farm' and 32,602 acre-feet 'at-river,' with the difference attributed to loss factors such as evaporation and seepage when the at-field values are backed up to IID's consumptive use accounting location at Imperial Dam.

Based on the finalization of the Bureau of Reclamation's 2011 decree accounting values, IID determined that the final conservation attributable to its 2011 following efforts was 63,278 acre-feet. The balance of the 80,000 acre-feet of water delivered to SDCWA was under contract in 2011, but wasn't physically conserved until the January through June 2012 period. As of June 30, 2012, IID has concluded its 2011-12 following program and created the full volume of conserved water associated with this program. Though precise 2012 conservation yields cannot be determined until the first quarter of 2013, IID is confident that the balance of the 2011 conservation shortfall has been satisfied and was 'paid back' to the river system, allowing this issue to be fully resolved.

In regard to the 2012-13 following program, IID has been very pleased with sign-ups given the late initiation of this program following the December 2012 appellate decision in the longstanding Quantification Settlement Agreement litigation. IID is still finalizing a few outstanding contracts but anticipates this program will generate over 180,000 acre-feet of conserved water for transfer, mitigation and 2011 overrun payback purposes through June 30, 2013. As we discussed, IID has been aggressively working to increase participation in its following efforts by increasing the payment rate, allowing for early and delayed following start dates to accommodate crop harvests, working with local growers to make agricultural lands owned by IID available for participation in this following program and developing a temporary land conversion following program.


Maureen Stapleton
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IID staff has already started working on its next following solicitation process, and anticipates kicking this effort off in the late summer/early fall. Staff is also working with local water users to develop new ideas that would add additional flexibility to future following programs, all in an effort to increase participation levels as fallowed water requirements ramp up.

Finally, IID is appreciative of SDCWA's joint participation in the State Water Resources Control Board petition to modify mitigation requirements for the IID/SDCWA transfer. The environmental assessment process is on schedule, as our agencies seek potential approval to eliminate mitigation water to the Salton Sea from 2014 through 2017. If granted, this could also serve to reduce fallowed water requirements for the same period. SWRCB approval of this petition could also allow for resolution of certain water accounting issues with the Bureau of Reclamation that have been outstanding since 2010. It may also allow the California water agencies to focus collaboratively on the continuing issues of accounting banding (schedule flexibility) and constraints on conservation that could be minimized by opportunities such as the expansion of intentionally created surplus conservation measures to include on-farm programs.

If you have any questions, please feel free to call me and thank you for your attention to the above.

Sincerely,



Kevin E. Kelley
General Manager

Copies to:
Terry Fulp, USBR
Steve Hvinden, USBR
Jeff Kightlinger, MWD
Steve Robbins, CVWD
Chris Harris, CRB

Allen Matkins

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Via Email/U.S. Mail

May 1, 2012

Scott S. Slater, Esq.
Brownstein Hyatt Farber Schreck, LLP
PO Drawer 720
Santa Barbara, CA 93102-0720

Re: **MWD Letter Of April 12, 2012**

Dear Mr. Slater:

The San Diego County Water Authority ("SDCWA") has forwarded to us a letter of April 12 which the Metropolitan Water District of Southern California ("MWD") sent to SDCWA, and has asked us for information related to IID's creation of the conserved water addressed in the letter. We summarize below what we believe are the key facts necessary, from IID's perspective, for SDCWA to consider on the topic of the IID 2011/2012 conserved water. We do not address MWD's claims about SDCWA's alleged duties under its Exchange Agreement with MWD.

Because this letter provides some extensive detail, it may be helpful to first summarize the main points that are presented below:

- MWD's stated concern regarding conservation is that SDCWA received 80,000 acre-feet of water in 2011, through IID's conservation in that actual calendar year turned out to be about 64,000 acre-feet, with the remainder being made up shortly thereafter. However, SDCWA generally receives the contracted water in advance of its creation, with any shortfalls addressed via the IOPP program discussed below. No entity is losing any water as a result.
- MWD is well aware of the important facts around this short-lived deficit. Due to QSA litigation, 80,000 acre-feet of conserved water was placed under contract in 2011, but not all of it could be fully created until early 2012. Given the facts detailed below, this situation was understandable, and should not give rise to controversy.

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- The Bureau of Reclamation (the "Bureau") was advised of the issue, and still has the matter under review. The QSA framework allows for overrun accounting adjustments, if necessary.
- The same parties faced an analogous situation in 2003 and 2004, when water created in 2004 was used for 2003 conservation requirements, and the overrun was handled by the Bureau without formal dispute (the Bureau waived payback for other reasons).

1. Relevant QSA Background Facts

a. QSA Mitigation

IID is implementing the largest efficiency-based water transfer project in the history of the United States, pursuant to the Quantification Settlement Agreement and related contracts (the "QSA and Related Agreements"). The QSA and Related Agreements call for various conserved water transfers from IID. Those transfers cause meaningful environmental impacts in the Imperial Valley region which require mitigation. That mitigation was ordered by the State Water Resources Control Board (the "SWRCB") as a condition of transfer approval. If the mandated mitigation does not occur, then the IID conserved transfers cannot occur.

The funding for QSA mitigation is managed through the QSA Joint Powers Authority ("QSA JPA"), which operates under the QSA JPA Agreement. That QSA JPA Agreement was one of 11 QSA-related contracts (including the QSA itself) voided by a judgment from the Sacramento Superior Court in 2010, with that judgment pending appeal until late 2011, when the judgment was overturned.¹ But for a temporary stay, and then the ultimate appellate decision, the QSA transfers, and all mitigation funding for them under the QSA JPA Agreement, would have been legally prohibited. This was a critical problem for IID and all QSA parties in 2011, as discussed below.

Under the IID-SDCWA transfer agreement, section 6.6, SDCWA has complete discretion as of January 1 of each year as to when to take the scheduled IID transfer water for that year. Thus, for example, if SDCWA were scheduled to receive 80,000 af in a given year, it could take the whole amount in January of that year, even though the conserved water might not actually be created until later in that year. Thus, the transfer is not set up in a manner where the water is created first and then taken later by SDCWA, but rather is structured to allow SDCWA to take the water before it is actually created. Of course, many things could happen later in the year to impede the actual conservation, such as conservation measures which did not work, contract breaches by conserving farmers, or litigation events. If there are shortfalls in the conservation, such could result in overrun events in connection with the Bureau's Colorado River accounting.

¹ Quantification Settlement Agreement Cases (2011) 201 Cal.App.4th 758.

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b. IID Conservation And The IOPP

IID is managing water orders of up to 3,100,000 acre-feet annually. Involved in the management of the QSA and Related Agreements are a myriad of variables such as rainfall, salinity, crop changes in response to agricultural commodity markets, maintenance and replacement projects, environmental mitigation requirements, conservation programs, measurement, monitoring and verification, etc.

Because of many such factors, IID cannot always achieve exact conservation targets with precision accuracy. IID's service area contains more than a half-million acres of farmland, thousands of miles of canals and drains and hundreds of control structures, reservoirs, and operational facilities all serving a \$1 billion-plus agricultural economic sector that includes hundreds of farming entities and the entire Imperial Valley community.

When the parties contracted under the QSA, MWD and the Bureau knew that the IID would require flexibility in its conservation activities due to the kinds of factors discussed above. The QSA itself specifies that it is premised on the Bureau's Inadvertent Overrun and Payback Policy (the "IOPP") as a "special consideration" in Section 6.2(4). The IOPP references "water conservation measures and operating practices" in the scope of discussion about inadvertent overruns.

IID's consumptive use cap, its "available supply," is determined by its annual diversion less return flow credits, conservation program yields and other authorized reductions. IID submits its water order estimate in advance of the calendar year, and the Bureau approves this order, after the appropriate Part 417 consultation process, with the explicit understanding that water orders submitted in advance of the water year are merely estimates of anticipated water use that may need adjustment throughout the year based on any number of variables. To the extent weather conditions and cropping patterns affect IID's annual water uses and, on occasion, cause inadvertent overruns, the conservation program yields will similarly vary from the values estimated in the initial annual water order. Should IID fail to create the full volume of conserved water anticipated each year, or should its agricultural demands exceed its annual supply, an inadvertent overrun will occur and be subject to the Bureau's payback requirements.

Therefore, the IOPP program allows the Bureau -- and QSA participants -- to have some flexibility as to year-to-year consumptive use of Colorado River water.

2. Key 2011/2012 Facts

As MWD is well aware, IID and all QSA parties faced highly unusual facts and challenges in 2011 that presented them with several QSA implementation issues. The QSA and certain related agreements had been voided by a judgment of the Sacramento Superior Court, with that judgment awaiting an imminent appellate decision. The QSA transfers would have been legally prohibited (absent a stay) upon affirmance of the judgment. While IID had conducted nine successful fallowing programs since 2003, conserved over 700,000 acre-feet of water, and met its scheduled

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transfer and payback requirements (often early)², IID foresaw great difficulty in implementing fallowing contracts for its 2011-2012 fallowing program with risk of no mitigation funding caused by the looming appellate decision.

There was a meaningful risk that SWRCB-mandated conservation measures would not be paid if the judgment were affirmed. For IID to conserve water, it not only needs contracts with farmers (discussed below), but also assurance of funding from the QSA JPA for mandated environmental mitigation. If the trial court's judgment were not reversed, the QSA JPA Agreement would be invalid, and thus no mitigation payments could be made pursuant to it, and thus no transfers could occur. At the time of contracting for water in 2011, it was reasonably expected that the stay pending appeal would expire with the appellate decision. If that decision affirmed the trial court, the mitigation funding and transfers would be shut down.

With a July 1, 2011 fallowing program start date (fallowing programs operate on a mid-year-to-mid-year basis to coincide with cropping patterns and farm lease transition dates), IID generally begins its solicitation process at least nine months in advance to accommodate agricultural planning timeframes. Operating under a stay issued in May 2010, the uncertainty associated with the ongoing litigation raised significant concerns regarding IID's ability to transfer any water conserved by fallowing in 2011, or to mitigate the environmental effects of such transfers. IID would not be guaranteed payment for this conserved water or payment for mitigation from the QSA JPA, and its payment obligations to fallowing program participants could not be conditioned upon a valid QSA or the district's receipt of conserved water payments. Additionally, should a fallowing program be interrupted, it was unlikely these fields could be put back into agricultural production in a timely manner due to the limitations of crop planting and farm schedules. Due to the judgment of invalidity risk, IID was therefore unable to continue at full-speed with its usual fallowing program and contracting process, and instead had to resort to an alternate and more deliberate implementation approach.

² IID has worked diligently to uphold its contractual commitments, and in fact has often performed earlier than required. To date IID has created and transferred approximately 400,000 acre-feet of conserved water to SDCWA, 40,000 acre-feet to CVWD, over 175,000 acre-feet to the Colorado River system via Exhibit C and other payback obligations, and over 165,000 acre-feet to meet required Salton Sea mitigation obligations. This is in addition to the annual satisfaction of 11,500 acre-feet of miscellaneous PPRs, its 3,100,000 acre-feet consumptive use cap, over 100,000 acre-feet of conservation annually from the IID/MWD program, and the 67,700 acre-feet of conserved water transferred to SDCWA annually via the All-American Canal lining project.

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IID delayed initiation of its 2011-2012 fallowing program solicitation and contracting process for as long as possible, all the while hoping for the resolution that an appellate court decision might bring. IID did contract to conserve the full 80,000 acre-feet SDCWA transfer obligation in 2011; however, given the July 1, 2011 - June 30, 2012 fallowing term, approximately 15,800 acre-feet of this fallowing program's conserved water yield (provisionally estimated at 31,600 acre-feet) would be generated in the second half of the current fallowing program (the six-month period from January 1, 2012 through June 30, 2012). This was a prudent and necessary measure to deal with the uncertainty of an appellate result. Enough water was put under contract to meet the obligation to SDCWA, but about half was rolled into 2012, when there might be no payments for mitigation and transfers.

These kinds of difficulties and uncertainties are exactly what the IOPP was designed to address, and indeed the IOPP was used in this manner to deal with a similar situation in 2003 and 2004.

3. 2003/2004 Precedent

The current situation, where IID will have to conserve some 2011 water in 2012 (water that was already contracted for in 2011), is no different conceptually than the situation in 2003, when IID did not have time to create the annual volume of conserved water for transfer and for Salton Sea mitigation purposes in the remainder of the calendar year after the execution of the QSA in October 2003. IID contracted in 2003 to make up the shortfall in 2004. IID, per its contractual commitments and under the IOPP, makes up the conserved water so that none is lost to the stakeholders or to the Colorado River.

The 2003/2004 scenario was explained in IID General Manager Silva's letter of February 26, 2004 to SDCWA General Manager Maureen Stapleton. A copy of that letter is attached as Exhibit "A." In that letter Mr. Silva stated:

As you know, the California SWRCB did not inform IID and SDCWA of its approval of the Salton Sea mitigation water provision and mitigation schedule until January 7, 2004 (copy attached for your convenience), too late for IID to implement the creation of fallowed Conserved Water in 2003, and for SDCWA to receive the transfer and exchange it with CVWD in 2003. Thus, during calendar year 2004, IID will create 5,000 AF of Conserved Water for 2003 plus 10,000 AF of Conserved Water for 2004, all by fallowing, and reduce its 2004 diversion from the Colorado River at Imperial Dam, net of return flows, in that combined amount consistent with Sections 3.6(a) and 6.5 of the IID/SDCWA Transfer Agreement, as amended.

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Attorneys at Law

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The use of 2004 conservation to be applied for 2003 requirements was approved by the Bureau. In its 2004 official accounting document³, on page 42 (copy attached as Exhibit "B"), the Bureau showed the 2004 conserved water, and noted its application to the 2003 contractual requirements:

The CRWDA specified required conservation by IID for transfer to SDCWA. The 2004 CRWDA schedule called for 20,000 af conservation by IID for the SDCWA Transfer, and another 10,000 af of conservation by IID for SDCWA Mitigation Transfer. [Because] IID was unable to conserve the SDCWA Mitigation Transfer component of 5,000 af in 2003, this has been added to the 2004 amount

The Bureau waived the overrun payback for 2003. The math for 2003/2004 is fully shown in IID's annual reports to the State Water Resources Control Board (reports which are sent to MWD, the Bureau, and CVWD each year). Attached as Exhibit "C" are exemplar excerpt pages from that report. You will see that on page 8 of 29, SDCWA received 10,000 af in 2003, yet IID only created 3,445 af by way of fallowing. This resulted in, as stated on this page, an inadvertent overrun of 6,555 af reported by the Bureau, which was then waived by the Bureau, as noted in footnote 2 on the same page:

Since the QSA was executed in October of 2003, IID was able to only fallow 3,445 AF and therefore had an inadvertent overrun of 6,555 AF which was used to satisfy IID's 10,000 AF obligation to SDCWA. The USBR waived payback for 2003 overruns for all Lower Basin entities.

The Bureau is well aware of the 2011/2012 issue as well, and has not made any final determinations. On December 30, 2011, Reclamation sent a letter to IID addressing IID's 2011 diversions. A copy of that letter is attached as Exhibit "D." On the second page of the letter, Bureau Regional Director Ms. Lorri Gray-Lee states:

In 2011, IID notified Reclamation that IID does not expect to conserve the full 80,000 acre-feet necessary to meet the scheduled transfer of Colorado River water to SDCWA in 2011, as set forth in Column 5, Exhibit B, of the CRWDA. The appropriate accounting for this circumstance is under review by Reclamation.

IID believes the issue is still under consideration by the Bureau. Until the 2011/2012 issue is addressed by the Bureau, it seems premature for MWD to claim that it will act preemptively simply on SDCWA's report (page 2 of the MWD April 12 letter to SDCWA).

³ "Colorado River Accounting and Water Use Report Arizona, California, and Nevada."

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Finally, it should be noted that if MWD unilaterally acts, it can create an improper windfall for itself. Per its contract with IID, in 2011 SDCWA took 80,000 af of IID water and delivered such to MWD under the MWD-SDCWA Exchange Agreement. MWD then delivered exchange water in like amount to SDCWA in 2011. If MWD now adjusts SDCWA's water, and the Bureau charges IID with an overrun, MWD would be getting water twice: both via its threatened adjustment with SDCWA, and by the Bureau cutting IID's water in 2012 by a like amount, with such water flowing to MWD under the priority schedule. Obviously, this would not be in accord with accepted practice or principles.

4. Conclusion

To the extent you need any further information from IID on the matters addressed above, please let me know. IID desires to do whatever it can to help resolve these issues amicably with all parties.

Very truly yours,



Mark J. Hattam

MJH:hmc
Enclosures

cc: Jeffrey M. Garber, Esq.
David L. Osias, Esq.