DECEMBER 11, 1997

SUMMARY OF BASIC TERMS

IID-SAN DIEGO WATER CONSERVATION TRANSFER AGREEMENT

- Purpose of agreement
- Status of water transferred
- Transportation of water
- Quantity
- Additional conserved water
- Term
- Pricing
- Shortage premium
- Price redetermination
- Shortage sharing
- Environmental compliance
- Approvals
- Contingencies
- Other provisions

Note: This summary is presented only for the benefit of providing an overview of a complex agreement. This summary is not intended to be a substitute for the terms of the agreement. Readers should refer to the agreement itself for a complete understanding of specific provisions.

1. __Purpose of agreement__ - The agreement provides that the Imperial Irrigation District (IID) will undertake and will contract with Imperial Valley landowners to undertake water conservation efforts in order to reduce the use of Colorado River water within IID. The agreement also provides that IID will transfer the conserved water to San Diego County Water Authority (Authority) in exchange for monetary payments from the Authority. IID and the Authority will use their best efforts to cooperate during the term of the agreement to achieve its purpose.

__Comment__: *The Authority will acquire an independent, reliable, alternate long-term water supply to provide drought protection and to accommodate anticipated growth in municipal, domestic, and agricultural uses. IID and valley farmers will receive the funding necessary to proceed with innovative water conservation efforts that IID and the landowners can undertake without resorting to the fallowing of productive farmland. Southern California as a whole will benefit since this transfer is viewed as a linchpin to a broader resolution of problems which relate to the overall management of the Colorado River. As an essential part of the "California Plan" to live within California's 4.4 million acre feet Colorado River apportionment, the IID-Authority transfer should lead to modified river operations which will be of significant benefit to the Authority and the other MWD member agencies.*

2. __*Status of water transferred*__

a) The agreement does not provide for any transfer or assignment of IID's senior water rights to the Authority. Rather, the Authority will have a right to use the water conserved within IID during the term of the agreement and during any renewal period. At the end of the transfer period, and any renewal period, the conserved water will return to IID for future use.

b) For Colorado River accounting purposes, and as part of the reliability the Authority is paying to obtain, the conserved water transferred to the Authority will retain the senior priority of IID's water rights.

c) The agreement provides that the transfer will be carried out under the authority of California Water Code section 1011, which facilitates transfers of this type. Under that statutory authority, the beneficial use and the senior water rights remain with IID, so the use of conserved water by the Authority will be viewed by the Secretary of the Interior (Secretary), for Colorado River accounting purposes, as part of IID's water use.

3. __Transportation of water__

a) The agreement provides that it is the Authority's responsibility to provide for transportation of the conserved water to the Authority's service area. IID's responsibility is to provide the conserved water to the Authority at Imperial Dam. IID and the Authority will work together to secure approval for the diversion of the water at Lake Havasu on the Colorado River. It is the Authority's responsibility to arrange for the transportation of the conserved water through the MWD delivery system.

b) The agreement is contingent on the Authority, within two years of the execution of the agreement, being able to obtain from MWD an acceptable long-term wheeling agreement. The wheeling rate will reflect only the cost of use of those reaches of the MWD delivery system required to wheel the conserved water from the Colorado River to the Authority's delivery system in San Diego County.

c) The agreement recognizes that from time to time MWD may be able to fill its aqueduct on a month-to-month basis with water released from Lake Mead for flood control purposes. During such events the agreement provides that the Authority and IID will share payment of a supplemental wheeling charge which will allow for the delivery of the IID conserved water through the MWD system, notwithstanding the availability of flood control water.

4. Quantity

a) Since the production of conserved water will depend on the level of voluntary landowner participation, the agreement does not set a specific amount of water that will be transferred from IID to the Authority. Rather, the agreement sets a ceiling of no more than 200,000 acre feet, and sets a minimum amount of 130,000 acre feet. In other words, if as a result of landowner participation commitments IID can only produce an amount of conserved water, which is less than 130,000 acre feet, there will be no agreement and no transfer of water. The 130,000 acre feet is based on what the Authority and IID see as the minimum amount necessary for the agreement to be implemented.

b) The initial transfer target date is 1999, or whenever the conditions necessary for the agreement to be finalized are satisfied or waived, whichever is later.

c) The initial transfer quantity is 20,000 acre feet for the first year, with a build up of 20,000 acre feet per year thereafter for a period of ten years or until the transfer amount is reached. The maximum amount that can be transferred is 200,000 acre feet, but a lesser amount (above 130,000 acre feet may be the final transfer amount depending on the level of landowner participation and whether IID undertakes any system conservation measures.

d) If the agreement is renewed, IID has the ability to take back 34,000 acre feet of the transferred water after the 1988 IID-MWD transfer agreement has been terminated (as early as 2033) and returns to the valley 106,000 acre feet. The purpose of this "recapture arrangement" is to allow IID to provide water for the valley's municipal and industrial needs if growth projections warrant the need for this water.

e) The Authority has the right to engage in temporary re-transfers of the conserved water to other public water suppliers as necessary to respond to emergencies, natural disasters, or system failures. Such re-transfers cannot have any injurious effect on IID.

5. Additional conserved water

a) The agreement provides that additional conserved water may be made available by IID in the future if IID determines to do so in its complete discretion. The maximum amount of additional conserved water that may be provided to the Authority is 100,000 acre feet.

b) The price for any additional conserved water will be the same as the price for the base amount of transferred water.

c) Discussions concerning the transfer of additional conserved water may take place within years 4 through 10 of the agreement (during the ramp up period), but the agreement provides that no additional conserved water will be provided to the Authority until on or after year 11 of the transfer agreement.

d) If IID decides to produce additional conserved water the Authority has the right to purchase that water. However, the agreement recognizes that IID may need some of that additional conserved water for other purposes, such as settling disputes with MWD or Coachella. Accordingly, the agreement provides that IID has the right, within the first seven years of the transfer agreement, to exclude water from the amount of additional conserved water made available so as to settle legal disputes with MWD or Coachella.

e) Additional conserved water specifically does not include water generated as a result of the 1988 IID-MWD transfer agreement and also does not include water saved by conserving seepage from the All American Canal.

6. Term

a) The initial term of the transfer agreement is 45 years from the effective date (after certain conditions are satisfied or waived). If the agreement is not renewed at the end of the 45 year period the agreement terminates. Any additional conserved water made available by IID to the Authority would also be available during the 45 year initial term of the base transfer agreement.

b) The agreement may be renewed for an additional period of 30 years. Both IID and the Authority have the unilateral right to renew the agreement for the 30 year renewal period. Renewal of the agreement may be avoided by either party if there is a material change in the wheeling arrangement. IID's right to recapture 34,000 acre feet for municipal and industrial purposes goes into effect when the renewal term commences. If the agreement is renewed, then the initial and additional conserved water will be available to the Authority.

c) Although the agreement provides no obligation for either party to continue the transfer agreement beyond 75 years, the agreement provides that IID and the Authority will meet and confer during the latter part of the renewal period in order to discuss the possible continuation of the transfer agreement beyond the end of the renewal period. Any continuation of the agreement beyond the renewal term would be under terms negotiated by the parties at that time.

d) The agreement provides cross "rights of first refusal" to IID and the Authority in regard to post-renewal period transfers. In other words, for a period of ten years after the end of the renewal period, IID has a right of first refusal to *supply* water to the Authority if the Authority attempts to obtain water elsewhere, and the Authority has a right of first refusal to *purchase* conserved water from IID if IID attempts to transfer conserved water elsewhere.

7. <u>Pricing</u>

a) The focus of this conservation/transfer agreement is the production of conserved water through on-farm conservation measures.

<u>Comment</u>: The price of the conserved water is a reflection of the perspectives of the parties. From IID's perspective, the price must be high enough to cover the cost of conserving the water plus an incentive to encourage participation by farmers, and also district and environmental costs and community benefits. From the Authority's perspective, the price paid to IID, plus what it will need to pay to wheel the conserved water to San Diego County, must be competitive with what the Authority pays MWD for water.

It is important to recognize that over the past 50 years IID and valley farmers have done a great deal to conserve water, everything from lining canals and laterals to laser-leveling fields. Also, a number of system and on-farm conservation measures were implemented through the 1988 IID-MWD conservation/transfer agreement. As a result, the remaining opportunities for water conservation within the valley are generally more difficult and expensive than what has been done in the past, and therefore reflect a higher price for producing the conserved water. The transfer price reflects considerable due diligence by both IID and the Authority in confirming the costs to produce water on-farm through measures such as pumpback systems.

b) The pricing arrangement is made up of a number of different components: the amount MWD charges for water within its service area, the wheeling rate to move the conserved water through the MWD system, and a price discount for the Authority which declines over the first 17 years of the agreement.

- The starting point for understanding the pricing arrangement is the MWD full water rate which equals the MWD price for untreated full service water plus other applicable MWD rates and charges

- Subtract from the full MWD rate the estimated cost of wheeling the conserved water through the MWD system.

- A discount is applied, which begins at 25 percent in year one of the agreement and declines over 17 years to a flat discount of five percent for the remainder of the agreement.

- Finally, if the conserved water would displace flood control water, the Authority and IID will share in the payment to MWD of a supplemental wheeling charge.

- Example of the pricing formula:

MWD untreated water rate	$349/AF
Other MWD charges	+51
MWD "full rate"	400
BASE wheeling rate	-68.50
	331.50
25 percent discount (year 1)	-82.87
Base price	$248.63/AF

c) Although the agreement uses a specific assumed wheeling rate in order to determine the price of the conserved water, the agreement recognizes that the actual wheeling rate could be different. The pricing formula provides for IID and the Authority to equally share the amount, if any, that the actual wheeling rate varies from the base wheeling rate, subject to a ceiling as to what will be paid by IID and the Authority.

- In the example above, if the actual wheeling rate is $78.50 per acre foot and the base wheeling rate is $68.50 per acre foot, IID and the Authority would split the $10 difference, making the base price $243.63 per acre foot. However, in regard to IID's and the Authority's responsibility, there is a cap on the amount the actual wheeling rate may exceed the base wheeling rate.

8. *Shortage premium*

In addition to the base price, the Authority will make additional payments to IID when the Authority declares a shortage or imposes mandatory rationing or conservation, 2) the State of California declares a critically dry condition for the state water project, or 3) the Secretary declares a shortage for the lower Colorado River.

Comment: Given the limited water supplies available to the Authority, the reliability of IID's senior water rights is a point of significant value in this transaction. In times of water shortage, the reliability of IID's water rights has even more value to the Authority, and that fact is reflected in the agreement.

9. **Price redetermination**

a) The price redetermination process cannot be engaged prior to year 10 of the transfer agreement. After that time, either IID or the Authority may request the commencement of the price redetermination process only if certain conditions are satisfied; for example: 1) the water market in California has matured to the extent that there are sufficient eligible transactions which may be used as comparables, and 2) at least ten years has passed since the last redetermination or there have been numerous recent transactions upon which a redetermination judgment may be made.

b) The agreement provides for the adjustment of comparable transaction prices based upon factors such as water reliability, water quality, and location.

Comment: As with the justification for the base price, the parties have different perspectives in regard to what may occur in the future with the cost of obtaining water and how the water market will develop within California. IID believes that high-priority water will remain in relatively short supply and that demand will grow. The Authority, on the other hand, anticipates that technological changes could suppress water prices, and the overall cost of obtaining water could go down. Because of these different perspectives, IID and the Authority have agreed to price redetermination provisions which will allow for the base price to periodically adjust to market conditions in the future. It is expected that reliance on the redetermination process will grow over time with the development of the California water market.

10. Shortage sharing

a) In light of the senior position of IID's water rights compared to other entitlements within the lower basin of California, Arizona, and Nevada, it is unlikely that IID's water rights would be affected, even under shortage conditions, anytime in the foreseeable future. Nevertheless, since the reliability of the water transferred to the Authority is grounded in IID's senior water rights, the agreement addresses what will happen if a shortage on the river ever impacts IID's rights.

b) The agreement provides that IID and the Authority will share, on a pro-rata basis, any reductions in water available to IID as a result of a shortage declaration by the Secretary of the Interior. For example, if a shortage declaration resulted in a 100,000 acre feet reduction in the amount of water available to IID, that reduction would be shared by IID and the Authority. If the transfer agreement resulted in a transfer of the full 200,000 acre feet to the Authority, the Authority would be responsible for 6,500 acre feet of the cut-back, and IID would be responsible for 93,500 acre feet of the cut-back (assuming an overall entitlement to IID of 3.1 million acre feet).

c) If a shortage condition affects both parties, the agreement provides for the parties to meet and confer regarding the possibility of negotiating a supplemental transfer agreement between IID and the Authority, so that the Authority may obtain a means by which to maintain its full supply of water. The terms and conditions of any supplemental transfer agreement would be negotiated at that time.

d) If a supplemental agreement is not entered into, the agreement provides that the Authority will have a right of first refusal as to any transferred water offered by IID to third parties during the shortage. Also, if supplemental water is not available from IID, and IID has not offered transfer water to others, the Authority is allowed to mitigate its shortage situation by entering into an agreement with a third party for a replacement supply of water. If that action is taken, the agreement provides that IID will share in the cost of providing that mitigation water source for the Authority, subject to certain ceilings as to IID's responsibility. The right of first refusal and any IID financial obligation would terminate with the end of the shortage.

11. Environmental compliance

a) In a transaction such as this it is very difficult to forecast what might be required of the parties as a result of compliance with laws such as the California Environmental Quality Act (CEQA) and the National Environmental Policy Act (NEPA). Sometimes with both CEQA and NEPA compliance processes the parties proposing an action may have to cover certain costs designed to mitigate the impacts of the transaction on the environment.

b) IID and the Authority agree that the implementation of the agreement will be contingent on compliance with CEQA and NEPA. The agreement delineates where IID has environmental responsibility and where the Authority has environmental responsibility. IID's responsibility extends to the Imperial Valley and the Salton Sea, and the Authority's responsibility extends to San Diego County, movement of the conserved water through the MWD system, and any consequences on the Colorado River stemming from changing the diversion point from Imperial Dam to Lake Havasu.

c) The agreement also divides the environmental compliance components into pre-effective date and post-effective date responsibilities. For both parties the agreement provides exit provisions which allow either IID or the Authority to walk away from the agreement if the environmental mitigation costs exceed the maximum amounts allowed. For example, the agreement provides that the maximum amount that IID will spend on pre-effective date mitigation is $15 million, and the maximum amount IID will spend on post-effective date unexpected environmental consequences will be $15 million, for a total exposure of $30 million.

Comment: It is not expected that environmental compliance costs will reach or exceed the limits provided for in the agreement. However, for a transaction of this magnitude, and given the linkage between this transaction and the Salton Sea, it was determined that the prudent course would be to provide for considerable flexibility prior to being compelled to terminate the agreement. Also, even though the agreement provides that IID's area of responsibility covers the Salton Sea, it was determined that the overall benefits of the transfer, including factors such as base price and shortage premium, justified the assumption of that responsibility.

12. Approvals

a) One of the conditions imposed in the agreement is that the transfer will be approved by the State Water Resources Control Board (SWRCB) within five years of when the agreement is executed. Approval by the SWRCB will cover such matters as: this transfer is consistent with California Water Code Section 1011, oversight by the SWRCB, state constitutional requirements that water be used reasonably and beneficially, and verification of water conservation.

b) In addition to approval of the SWRCB, it is also a condition to obtain, within six years of the execution date, the approval of the Bureau of Reclamation (BOR). BOR's approval will cover such matters as the change in the diversion point from Imperial Dam to Lake Havasu and decree accounting.

13. Contingencies

a) The agreement is arranged so that it cannot become effective unless a number of conditions or contingencies are either satisfied or waived.

b) Examples of conditions imposed on IID:

-Within one year from the execution date, complete the contracting process with participating landowners so as to conserve at least 130,000 acre-feet at the end of the ramp up period.

-Obtain approvals from SWRCB (within five years) and BOR (within six years).

-Within five years of the execution date, complete state and federal environmental compliance processes.

c) Examples of conditions imposed on the Authority:

-Within two years from the execution date, obtain an appropriate long-term wheeling agreement with MWD.

-Within five years from the execution date, complete state and federal environmental compliance processes.

14. Other provisions

a) The Authority's contractual relationship is with IID and will not extend to the contracts regarding on-farm water conservation between IID and participating landowners.

b) The decision as to whether to participate in the conservation/transfer program will be voluntary, and will be up to the participating landowners.

c) Any reduction in the quantification of IID's senior water rights as a result of legal challenges will not result in a reduction of the conserved water quantity being transferred to the Authority.

d) IID bears the risk of non-performance by participating landowners.