MINUTES

WORKSHOP OF THE

BOARD OF DIRECTORS

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

APRIL 22, 2003

45299 The Board of Directors of The Metropolitan Water District of Southern California held a workshop in the Board Room located in the building at 700 North Alameda Street in the city of Los Angeles, state of California, on Tuesday, April 22, 2003.

Chairman Pace called the workshop to order at 2:02 p.m.

45300 Present at the workshop were: Directors Bakall, Bannister, Brick, Brown, Coughran, Edwards, Fellow, Foley, Grandsen, Hansen, Loveland, Morris, Morse, Murray, Mylne, Pace, Parker, Peterson, Record, Stanton, Turner, and Wright.

Those not present were: Directors Abdo, Blake, Castro, De Jesus, Dentler, Harris, Herman, Kwan (entered 2:20 p.m.), Lewis, Luddy, Mejia, Owen, Rez, and Troxel.

The Chair declared a quorum present.

45301 The Chair announced that this is a workshop to review the proposed Quantification Settlement Agreement (QSA). Last month a cost analysis on the QSA was distributed outlining three scenarios, their associated costs, and an outline of who would pay. The Board's job is now to consider the analysis and any public and member agency testimony on this analysis.

The Chair stated that this workshop is to help the Board better understand the costs of the QSA, or in the alternative, no QSA. A value judgment will have to be made on the pros and cons of each argument favoring the QSA or other alternatives. The Chair directed attention to the cost analysis and various comments received as they reveal local priorities and concerns that Metropolitan should consider in striking the right balance and approving the best course of action for not only our region but for California as a whole. Chairman Pace then called on the Chief Executive Officer to comment on the presentation of the staff analysis.

45302 Chief Executive Officer Gastelum stated General Counsel Kightlinger would begin the presentation with a brief report on the status of the Governor's current proposal. The Board had directed staff to negotiate on four items, and the General Counsel will report on those items. Following that, Chief Financial Officer Thomas would give a more detailed financial analysis. The San Diego County Water Authority would then make its presentation, to be followed by any other member agencies that wished to address the Board.

Director Kwan took her seat at 2:20 p.m.

General Counsel Kightlinger stated he would review the four issues that the Negotiating Committee for Metropolitan has asked to be addressed. The first issue that the Negotiating Committee wanted to see resolved was the Metropolitan transportation rate for the movement of water for the San Diego County Water Authority/Imperial Irrigation District (SDCWA/IID) transfer. Originally this water was going to be conserved by IID and moved to SDCWA through Metropolitan's Colorado River Aqueduct. The initial wheeling rate for that was discussed and was the subject of litigation. The litigation has been resolved but there was always the issue of what would be the appropriate rate to be charged. In 1998, an agreement was reached that the state of California would provide $235 million indirectly to Metropolitan for funding of the portions of the All American and Coachella Canals. Also, another $35 million of that $235 million would be provided for groundwater storage programs related to the implementation of the California Colorado River Water Use Plan. That $235 million would cover the difference between a reduced rate that Metropolitan would charge for the expansion of the SDCWA water and for 30 years. In effect this would cover the rate that SDCWA would pay the transportation for the first 30 years of that program. The SDCWA/IID program is for a 45-year initial term with the potential for renewal up to 75 years. The transportation for the SDCWA/IID water beyond year 30 has never been addressed as part of the QSA, so that was an open issue. That issue has now been resolved in the manner that SDCWA has agreed that Metropolitan's Board will be setting that transportation rate in its normal rate setting process. If that rate is not acceptable nor does not work for SDCWA, then SDCWA has the option of terminating its transfer with IID at year 35. SDCWA has further agreed in this process not to challenge or lobby against Metropolitan transportation rate.

The second issue put on the table by the Negotiating Committee was that of the IID litigation against the United States on the 2003 water order. In that litigation, IID put forward some allegations that appeared to challenge Metropolitan's ability to receive the conserved water that was created under the 1988 Metropolitan/IID conservation program. The Negotiating Committee specifically said that Metropolitan would not be able to enter into a QSA as long as this issue was not resolved. After discussions with IID and Coachella Valley Water District (CVWD) that issue has essentially been resolved. That really was a dispute between IID and CVWD on how the accounting for that water would be done under the priority system, and that the conserved water would be accounted for against the agricultural priority so that the benefits would be fully received by Metropolitan.

The third issue discussed by the Negotiating Committee was the appropriateness of using state funding to support the QSA transfer. Currently the proposal put forth by the state team calls for a potential of up to $350 million of state funding to be used — $200 million from Proposition 50 or other sources if they can be found, and a loan guarantee that could potentially be up to $150 million. Metropolitan had expressed concern with that in terms of whether or not that would be appropriate, and could using those funds set a precedent. Metropolitan would be the agency most likely to be impacted since it would be doing future water transfers. The Governor's team responded that they wished to still pursue getting those funds and they would pursue that through the legislative process. They agreed to draft language that would limit the precedent value by saying this is really a one-time deal and the overall benefits of the QSA, Interim Surplus Guidelines, etc., was not the policy of the state of California to put these types of funds in other transfers.

The fourth issue that was addressed was the potential guarantee of water delivery from IID to SDCWA in terms of the water transfer.

Using a PowerPoint presentation, Chief Financial Officer Thomas gave a brief overview of the analysis of the QSA and what the QSA entailed, the supplies, the costs of those alternatives, and the risks associated with or without the QSA. In the QSA, fundamentally, there are a lot of agreements among different parties on the Colorado River, different states, and Metropolitan's member agencies. Metropolitan has been negotiating an agreement with Palo Verde Irrigation District (PVID) in which Metropolitan will receive up to 111,000 acre-feet of water through a land management agreement. Metropolitan also has an agreement with San Diego to move San Diego's water that it acquired from IID. In addition, within the context of the QSA, Metropolitan has agreed to provide some of its PVID water to San Diego in the early years to help meet some of SDCWA's objectives and to move that water at the exchange rate. There is an environmental cost-sharing agreement which will be allocated among the different participants, including getting about $200 million worth of bond monies from the state to help mitigate any environmental cost as a result of this transfer.

There are also agreements through the QSA with Coachella Valley Water District (Coachella) in which Metropolitan would take on obligations to Coachella. One is to provide 20,000 acre-feet of water a year. In addition to that, Metropolitan would have to do an exchange of State project water for Colorado River water of about 35,000 acre-feet. Coachella would be paying Metropolitan the operating costs and the pumping costs incurred on the state water. In addition, further out in time in the QSA, Metropolitan would be obligated to help pay what amounts to about $150 million or more over the term of the QSA to help pay for some of Coachella's water which it would be receiving from IID.

Mr. Thomas further described the various risks involved in the QSA – the technical/economic, political, legal, and environmental risks. In reviewing the various components of the QSA, the following observations were noted:

- Cost impact to MWD rate approximately equal
- Most risks are difficult to quantify

- Interim Surplus Guidelines will provide less water than originally estimated
- Water quality is a significant risk with or without QSA
- Additional investments need to be made
- System and storage without the QSA supplies will be exercised more fully
- Local resources will need to be developed more quickly without the QSA
- Colorado water supplies require additional investments by urban Southern California

In conclusion, Mr. Thomas reported that comments from the member agencies included support of many components of the QSA and the risks involved, such as:

- Interim Surplus Guidelines and hydrologic risk
- Shortage sharing with Arizona
- QSA termination - permanent quantification
- Environmental issues - Salton Sea
- Use of Proposition 50 funds for IID Transfer Project
- Reasonable and beneficial use

45303 Maureen Stapleton, General Manager, and Robert Campbell, Executive Assistant to the General Manager, from the San Diego County Water Authority made their presentation in support of the QSA. Mr. Campbell reported on "MWD Water Supply Reliability: Managing Risk in a New Era." He described the various risks involved without the QSA — economic, water supply reliability, water supply, future, drought survival, and water storage.

Under the economic risk, he stated the Authority believes more would have to be spent for alternative supplies, water treatment, and there would be harm to the economy from potential water shortages.

Regarding the water supply reliability risk, he said the Authority believes there would be depletion of surface storage and groundwater storage. Under operating conjunctive use, the groundwater programs are at maximum threshold; and there would be reliance upon overly aggressive projection of potential water conservation and supply availability.

Under the water supply risk, he commented that the Authority believes there would be rapid depletion of existing storage, reduced ability to replenish storage, seasonal storage deliveries suspended, and an uncertain supply status with the Arizona water bank, the All American Canal lining, and the 1988 MWD/IID water transfer agreement.

As for future and drought survival risks, quotations were taken from Metropolitan's comments:

> "In addition to monetary costs...drawing upon all of these reserves now compromises MWD's ability to respond to future adverse water supply and quality conditions."
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> "To the extent that these storage reserves are reduced to offset a substantial reduction in Colorado River supplies for 2003, the ability of the region to survive multi-year droughts and to implement water management programs is compromised."

Under the water storage risk, the question was asked: "What if the next few years are also dry and surface storage continues to be reduced 400 taf/yr.?"

Other factors mentioned with no-QSA alternative include the fact that existing local supply cannot fill the gap, loss of core supplies, overly aggressive estimates, potential shortages, and existing water supplies at risk.

In summary, San Diego opined that the QSA manages risk best and provides the time to implement new local supply programs, $650 million in savings to develop local supplies, the surplus water to make conjunctive use programs work, 15 years of "breathing room", and long-term core supply reliability.

Board Secretary Hansen withdrew from the Meeting at 3:33 p.m.

45304 Chairman Pace invited member agencies and the public to address the Board.

Joseph Grindstaff, General Manager, Santa Ana Watershed Project Authority, stated that the QSA and the transfers are both necessary and inevitable for Southern

California. He also believed that the Salton Sea must be stabilized and should be preserved at some point. Mr. Grindstaff expressed support for a QSA, but opposed the use of certain funds from Proposition 50 monies that were voted on by the electorate for local projects.

Director Fellow withdrew from the Meeting at 3:44 p.m.

Richard Atwater, Chief Executive Officer/General Manager of Inland Empire Utilities Agency, referred to the letter from his agency signed by John L. Anderson, President, Board of Directors, dated April 2, 2003, regarding the Colorado River QSA Negotiations. Realizing that the QSA negotiations and the obtaining of water from the Colorado River are complicated issues, Mr. Atwater reviewed the history and the action taken in the *Arizona v. California* case and requested that the Board carefully evaluate the current QSA terms. He also requested that additional workshops be held with more detailed discussions.

Matt Stone, Associate General Manager/Planning, Municipal Water District of Orange County, commented on certain objectives relating to the QSA discussions: permanent quantification, conservation investments, avoiding Salton Sea impacts, interim surplus guidelines and changed river hydrology, and pursuing a third resource strategy option. He stated the needs for agricultural ("ag") priority should be permanently quantified before any additional public or ratepayer dollars be spent in "ag" to urban conservation. It should also be made clear that the agencies are willing to pay for real and innovative conservation programs like IID 1, PVID, and the canal lining programs, but would not continue to make those investments without knowing that the water will make it through the unquantified "ag" priority system. Mr. Stone continued that transfers impacting the Salton Sea should not be a part of an initial plan to backfill for the loss of surplus Colorado River water and that this was a risky and costly part of the current QSA. He stated that California should not ask other states to provide interim surplus water due to the radically changed hydrology on the Colorado River. In summary, Mr. Stone said that Metropolitan should pursue a third resource planning option that is neither a "QSA" or "non-QSA" based option, but one that combines the most feasible elements of the current QSA.

Director Mylne withdrew from the Meeting at 4:05 p.m.

Jerry Gewe, Assistant General Manager/Water, Los Angeles Department of Water and Power, stated that dealing with the issue of the QSA is a weighing of risks on all sides, and that we have to move forward with the strategy to meet the needs of our customers because the impact on the economy is going to be far greater than the money risk on either of the options if nothing is done. Mr. Gewe commented that although Metropolitan has absolutely no connection with the Salton Sea issues, that once we get associated with it, past history shows that if there are "deep pockets" you end up getting heavily involved, and that is something that needs to be looked at carefully. But on the other hand, totally relying on local projects has its own downside. Mr. Gewe cautioned that Metropolitan and its member agencies, as a group, need to carefully evaluate the risks, especially a risk analysis from the standpoint of reliability to our investors.

45305 Discussions took place on the pros and cons of the QSA, and the need to have more workshops for the Directors to more fully delve into the issues.

Director Peterson stated that it is important for the Board to let their legislators know where Metropolitan stands on these issues because the legislators may not know what is taking place. Director Peterson commented on the use of Proposition 50 funds for the QSA, which is not what the public intended when they voted for it, and that should be made clear to the state.

Director Murray asked whether there is a schedule or a deadline by which a decision has to be made.

General Counsel Kightlinger reminded the Board of a letter dated March 12, 2003, that was signed by all the parties involved, and that Metropolitan's Board would not be executing any QSA and other documents until a number of things have occurred. An estimate of the time limit would be between July and October when a final package is expected.

Director Loveland spoke in support of the use of Proposition 50 funds to aid the QSA. He urged the Board to move forward and put in place a process that the Board members can ask their questions, get their answers, and be prepared to make a recommendation, which would influence how each one feels about the funding.

Director Murray withdrew from the Meeting at 4:26 p.m.

Director Brick moved, seconded by Director Edwards, that the Board of Directors of Metropolitan Water District was uncomfortable with the predetermined use of Proposition 50 funding and urged that these grant funds be distributed through a competitive process as the voters intended.

Following a discussion on the appropriateness of using Proposition 50 funds, Director Morris moved a substitute motion, seconded by Director Bannister and carried, that the original motion be tabled.

Directors Brick and Edwards requested to be recorded as voting no.

Chief Executive Officer Gastelum reiterated that staff is continuing to work diligently through the issues.

Chairman Pace requested staff to schedule another workshop on May 12, 2003.

45306 There being no objection, the Chair adjourned the workshop at 4:50 p.m.

Helen Z. Hansen
SECRETARY

Phillip J. Pace
CHAIRMAN