

• General Counsel's December 2004 Activity Report

Summary

This report discusses significant matters in which the Legal Department was involved during the month of December 2004.

Attachments

None

Detailed Report

1. Litigation/Claims To Which Metropolitan Is A Party

a. Arizona v. California III

In this longrunning lawsuit in which the Quechan Indian Tribe sued to increase the amount of its reserved water rights to Colorado River water for the Fort Yuma Indian Reservation, counsel for the Parties have negotiated a tentative settlement that they have agreed to present to their respective governing bodies for approval. In light of the tentative settlement, the Special Master has stayed further pretrial proceedings until January 31, 2005. The General Counsel will present the settlement to the Board at the January 2005 meeting.

b. Reorganized California Power Exchange v. Lambeck

The Legal Department received confirmation on December 20, 2004 that Aegis, the insurance company for the California Power Exchange (CAL PX), has agreed to indemnify Metropolitan for all outlays, expenses and attorney fees expended in this litigation - past, present and future. Summary judgment and a dismissal in favor of Metropolitan's employee who served on the CAL PX board is presently on appeal by the CAL PX. Aegis has dropped its insistence for a reservation of rights or potential for a refund in the event of a reversal and is limiting its reservation of rights for only fraud, etc. This action is a result of a sustained effort by the Legal Department and its outside counsel to reduce Metropolitan's exposure in a case of doubtful liability. We remain confident that the appeal will fail, but regardless of any expected outcome, there will be no expenses expended by Metropolitan in its defense.

c. OSA Related Litigation

In these coordinated cases that involve challenges to the Quantification Settlement Agreement (QSA) and its related agreements and approvals, Metropolitan filed demurrers to two amended petitions of the County of Imperial that seek to overturn the Imperial Irrigation District (IID)-San Diego County Water Authority (SDCWA) transfer agreement and the State Water Resources Control Board approval of the transfer. Metropolitan also filed an amended answer to IID's validation petition, which seeks a judicial determination that 13 agreements associated with the IID/SDCWA transfer and QSA are valid, legal and binding. Additionally, Metropolitan joined in two other demurrers that were filed against amended Imperial Group pleadings, which allege, among other things, that the QSA and related water transfer agreements violate CEQA and farmers' water rights. A hearing on the demurrers in Sacramento Superior Court is set for January 28, 2005.

d. Coordinated Proceedings in re State Water Resources Control Board Decision 1641

The parties to this coordinated appellate proceeding, including the State Water Contractors, filed their opening briefs in December 2004. State Water Resources Control Board's (SWRCB) D-1641 is a water rights decision issued in January 2000 resolving a number of issues involved in water rights hearings to implement the SWRCB's 1995 Bay-Delta Water Quality Control Plan. D-1641 was the subject of 14 separate actions that were coordinated in the Sacramento Superior Court. The State Water Contractors participated in the trial court in support of SWRCB's decision, and in May 2003 the trial court issued its decision essentially upholding D-1641. However, the court did invalidate the portion of D-1641 in which SWRCB relied on the San Joaquin River Agreement and Vernalis Adaptive Management Plan as the mechanism to meet San Joaquin River flow requirements. The State Water Contractors' opening brief on appeal defends the trial court's approval of D-1641 on issues of interest to the Contractors, but argues that the lower court's decision on the San Joaquin River Agreement and Vernalis Adaptive Management Plan should be reversed.

e. Shank/Balfour Beatty v. Metropolitan

On Wednesday, December 22, 2004, the final day of closing arguments in the Shank (now Ameron) litigation were held. All oral argument is now completed. Opposing Counsel has until January 7 to file any objections to Metropolitan's cross-complaints. If objections are filed, Metropolitan has until January 14 to respond. Assuming objections are filed and responded to, the case will be submitted as of January 14. If Ameron has no objections, they will so inform the court in writing and the case will be submitted on that date. The court has 60 days to render its opinion.

2. Other Matters Involving Metropolitan

a. National Marine Fisheries Service's Proposed Designation of Habitat for Central Valley Spring-run Salmon and Central Valley Steelhead

The National Marine Fisheries Service (NMFS) proposed to designate critical habitat for several "evolutionary significant units" (ESU) of Chinook salmon and steelhead on December 10, 2004. The ESUs affected include the Central Valley spring-run salmon and Central Valley steelhead. Section 4 of the Federal Endangered Species Act requires NMFS to designate critical habitat for listed species after considering the economic impacts of the designation. NMFS' previous designation of habit for a number of ESUs was invalidated in three separate federal district court cases because NMFS had failed to adequately consider the economic impacts of the designations. NMFS was directed to reconsider these critical habitat designations, ultimately leading to the proposal issued on December 10. The proposed designation includes habitat for the spring-run and steelhead on the Sacramento and Feather Rivers and in the Bay-Delta Estuary, which could have implications for State Water Project water supply and power operations. The State Water Contractors, including Metropolitan staff, currently are reviewing the proposal and plan to file comments on the proposed critical habitat designation by the February 8, 2005 deadline.

b. Electric Industry Restructuring

On December 21, 2004 the Federal Energy Regulatory Commission (FERC) issued an opinion in the California Independent System Operator Transmission Access Charge proceeding. Metropolitan and the State Water Contractors had actively participated in the hearing before the Administrative Law Judge (ALJ), seeking rejection of the Independent System Operator's (ISO)

flat hourly rate and acceptance of a time-differentiated transmission rate. The ALJ's Initial Decision found that while Department of Water Resources, Metropolitan and the State Water Contractors had presented strong arguments in favor of time-differentiated pricing, she felt bound by a prior Commission order finding the ISO's flat charge just and reasonable. FERC's recent opinion summarily affirmed the ALJ's finding on this issue, providing no comment. DWR, Metropolitan and the State Water Contractors will file a request for rehearing of this opinion within thirty days of its issuance, which is a condition precedent to the filing of a petition for review that will likely be filed at the District of Columbia Court of Appeals. Several recent opinions issued by that court and the Ninth Circuit have reversed FERC orders, chastising it for failing to discharge its responsibilities under the Federal Power Act. We hope to obtain a similar result in this proceeding.

3. Other Matters Not Involving Metropolitan

a. Tulare Lake Basin Water Storage District et al. v. United States

The United States has agreed to settle this case with a \$16.7 million dollar payment to plaintiffs. Plaintiffs—Tulare Lake Basin Water Storage Basin, Kern County Water Agency and three of their member agencies—sued the United States in the United States Court of Claims seeking damages of nearly \$65.7 million as compensation for water lost due to Federal Endangered Species Act (FESA) restrictions imposed on the State Water Project (SWP) during the years 1992-94. In 2001, the Court concluded that plaintiffs' state-established property rights in their SWP contracts were impaired by the imposition of FESA restrictions and that this impairment was subject to compensation under the Fifth Amendment of the United States Constitution. The Court subsequently awarded damages of \$13.9 million plus interest in 2003, and was considering plaintiffs request for \$2 million in litigation expenses, for a total of more than \$26 million when the case was settled. As part of the settlement, the United States will not appeal from the underlying legal determination that SWP contract rights are property rights subject to Fifth Amendment protection from federal action impairing those rights.

Because of its large SWP entitlement, Metropolitan did not suffer any diminishment of its water supply during 1992-94 that would have supported a similar claim. Also, the State Water Resources Control Board subsequently adopted the FESA restrictions in the SWP's water rights permits in 1995. Since the state-issued permit now includes those FESA restrictions, any loss in supplies caused by the restrictions cannot be the subject of a takings claim. However, subsequent new FESA restrictions that further restrict SWP operations could possibly be the basis for a Fifth Amendment claim.

b. Orange County Water District v. Northrop Corporation, et al.

The Orange County Water District recently filed an action in the Orange County Superior Court against Northrop Grumman Corp., Aerojet-General Corp., and several other corporate defendants seeking to protect Orange County groundwater resources from toxic pollution. Specifically, the complaint alleges that the defendants, through various manufacturing activities, were responsible for the discharge of various volatile organic compounds into the groundwater basin and seeks compensatory damages to investigate, monitor, and remediate contamination caused by the defendants' activities.

4. Finances

The Legal Department subscribed to Disclosure USA, an internet-based service for filing and dissemination of continuing disclosure notices for municipal bonds, and used this service to provide notice of Metropolitan's general obligation and water revenue bonds defeased with refunding bonds issued in November. We prepared annual statements of year-end financial information regarding both general obligation and water revenue bonds and transmitted them to Disclosure USA for filing.