

• General Counsel's July 2005 Activity Report

Summary

This report discusses significant matters in which the Legal Department was involved during the month of July 2005.

Attachments

None.

Detailed Report

1. Litigation/Claims To Which Metropolitan Is A Party

a. *Plaks, et al. v. MWD, et al.*,

This lawsuit was served on Metropolitan on July 7, 2005, and alleges some 19 separate causes of action due to impacts from construction of the Las Posas Feeder pipeline owned by Calleguas Municipal Water District. The 46 plaintiff groups consist of residents and businesses close to the pipeline construction. Metropolitan is a party to a groundwater storage conjunctive use program with Calleguas. Pursuant to our indemnification agreement, Calleguas will be handling this matter for Metropolitan.

2. Other Matters Involving Metropolitan

a. *Alameda County Flood Control & Water Conservation District, Zone 7, et al. v. California Department of Water Resources (Hyatt-Thermolito)*

As previously reported, a group of 14 State Water Project (SWP) contractors have filed suit against the California Department of Water Resources (DWR) challenging the manner in which it allocates certain energy costs and revenues pursuant to Article 22 of the State Water Contract (Contract).

On June 29, DWR filed a demurrer seeking to have the complaint dismissed in its entirety. DWR's demurrer is based upon several grounds, including the plaintiffs' delay in commencing this litigation. As noted in the demurrer, DWR has been administering Article 22 in the same manner for over 20 years. As such, there is no reason why the plaintiffs could not and should not have brought this action sooner. Plaintiffs have until August 5 to file an opposition to DWR's demurrer; DWR then will have until August 18 to file a reply. The demurrer currently is scheduled to be heard by the Court on August 26, 2005.

Metropolitan and its 12 coalition partners are awaiting the Court's decision on the demurrer. If granted, no further action would be necessary unless and until the plaintiffs file an amended complaint. If denied, then Metropolitan and its partners will move to intervene in the litigation in order to ensure that our interests are adequately represented.

b. *Audit of National Marine Fisheries Service's Biological Opinion Regarding CVP Operations Criteria and Plan*

The National Oceanic and Atmospheric Administration, Office of Audits, issued its finding on July 8, 2005 that the National Marine Fisheries Service's (NMFS) did not comply with its own internal review process when issuing the Biological Opinion for the Central Valley Project

Board Report (General Counsel's July 2005 Activity Report)

Operations Criteria and Plan (OCAP). The OCAP establishes the Bureau of Reclamation's rules for operating the CVP, including a description of associated SWP operations. NMFS issued its Endangered Species Act Section 7 Biological Opinion on October 22, 2004, finding that the OCAP would not jeopardize the Sacramento River winter-run and spring-run salmon or Central Valley steelhead. The Biological Opinion contains incidental take authorization allowing the SWP and CVP to continue operations consistent with the Opinion. The recent Office of Audits report found that in developing and issuing the Biological Opinion NMFS deviated from its normal Section 7 consultation process in that it began the Section 7 consultation process without sufficient information; the NMFS Assistant Regional Administrator approved the Biological Opinion rather than the designated NMFS Regional Section 7 Coordinator; and the Biological Opinion was issued without the NMFS General Counsel's review. The Office of Audits concluded that, while it did not address the "soundness" of the Biological Opinion itself, the process "raises questions about the integrity of the OCAP opinion." It recommended that NMFS review and re-issue its delegations and policies for Section 7 consultations within 6 months and "objectively evaluate whether the southwest regional office's questionable handling of the OCAP opinion impaired the opinion's scientific integrity." NMFS is seeking an outside organization to review the science underlying the opinion. This could result in a revised Biological Opinion, which could affect SWP operations.

c. *Natural Resources Defense Council, et al. v. Norton, et al.*

The State Water Contractors filed a motion with San Francisco Federal District Court trial judge Claudia Wilkin requesting that she reconsider her decision denying the Contractors' motion to intervene in this action. Judge Wilkins denied intervention because she believed that another intervening party—the Farm Bureau Federation—would adequately represent the Contractors' interests. This case involves a challenge to the United States Fish and Wildlife Service's Biological Opinion regarding the Central Valley Project OCAP, which provides an incidental take authorization for operation of both the CVP and SWP. The Contractors' Board of Directors also authorized an appeal of Judge Wilkins' decision if she does not reverse her initial intervention decision.

d. *Electric Industry Restructuring*

On July 1, 2005, the Federal Energy Regulatory Commission (FERC) issued another in a series of "guidance" orders to the California Independent System Operator (CAISO), scheduled for implementation in February 2007. CAISO had proposed a flatter "load aggregation" pricing formula that likely would have led to higher power prices for the water projects. Metropolitan argued that more pricing zones should be established. The State Water Project (SWP) also argued that wholesale power customers should be allowed to establish their own pricing zones. The FERC guidance order adopted the positions of Metropolitan and the SWP. Metropolitan and the SWP should each have a pricing zone, with the SWP possibly getting two, one for Northern California and one for Southern California. This order is a very positive and significant development for the SWP and Metropolitan, and should result in millions of dollars of energy savings per year.

e. *Laub v. Davis; Regional Council of Rural Counties v. State of California*

On July 27, the Third District Court of Appeal ordered oral argument in this appeal by the California Farm Bureau, Regional Council of Rural Counties, and Central Delta and South Delta Water Agencies of the lower court's decision upholding the CALFED EIR. Metropolitan is a

Board Report (General Counsel's July 2005 Activity Report)

respondent party to these consolidated cases to protect our interests in the CALFED process. Argument is scheduled for August 30.

f. NOAA Fisheries' Decision Regarding Listing for West Coast Salmonids

NOAA Fisheries issued its final determination regarding its status review of several Evolutionary Significant Units of West Coast salmon and steelhead June 28, 2005. NOAA decided to maintain the "threatened" status for the Central Valley spring-run salmon and the "endangered" status for the Sacramento River winter-run salmon. NOAA had initially proposed to revise the winter-run salmon status to threatened, but reversed that proposal after reviewing comments and the most recent science. This decision will have minimal impact on operation of the SWP because it has already been operating under restrictions based on spring-run's endangered and winter-run's threatened status. At the same time, NOAA extended the time for finalizing its status review for the threatened Central Valley steelhead and nine other steelhead ESUs for six months.

3. Matters of Interest Not Involving Metropolitan

a. Regents of the University of California v. East Bay Municipal Utility District

This decision, issued by the Court of Appeal on July 6, 2005, concludes that the capital component of water rates paid to EBMUD are capital facilities fees, for purposes of Government Code provisions limiting capital facilities fees that may be charged to public agencies, and awards a refund to the Regents for the excess charges. Public utilities may impose capital facilities fees on other public agencies in California, provided that they do not exceed the proportionate share of the cost of the public utility facilities of benefit to the agency being charged, based upon its proportionate use of those facilities. When the public agency being charged is a school district, community college, university or other educational agency or a state agency, the capital facilities fee must be necessary to defray the actual construction costs of that portion of a public utility facility actually serving the agency and (unless the parties agree to a higher fee) is subject to an inflation-adjusted limitation. This decision disregards long-standing distinctions between commodity charges (including water rates) and assessments imposed to cover the costs of capital facilities. Although it will not result in direct impacts on Metropolitan, this decision could affect rates charged by retail agencies to educational and state agencies and generate additional refund claims from their public agency customers.

4. Finances

Legal staff assisted finance staff and outside bond counsel with the closing of \$200,000,000 Water Revenue Bonds, 2005 Authorization Series A, B-1 and B-2. This bond issue included \$100,000,000 fixed rate bonds and \$100,000,000 variable rate bonds. The bonds were issued to finance capital improvements.

5. Legislation

After several years' effort, the U.S. House of Representatives and Senate enacted major energy legislation just prior to adjourning for the August recess. The Energy Policy Act of 2005, contains several important provisions for Metropolitan. Metropolitan had successfully lobbied for insertion of special text in the bill that preserves our priority right to use our 230 kV transmission line to serve Colorado River Aqueduct pump load. Without such text, Metropolitan might have had to compete with others for use of our transmission line if the line became part of a regional transmission organization. In addition, the bill contains the Cantwell amendment,

Board Report (General Counsel's July 2005 Activity Report)

which provides that FERC has exclusive jurisdiction over claims for payments in termination of certain energy purchase contracts. This would cause the bulk of Enron's claim for a termination payment from Metropolitan to be moved to FERC from bankruptcy court.

In addition, the energy bill gives FERC significant new responsibilities to oversee and enforce mandatory power grid reliability rules, to protect against market manipulation and the exercise of market power, to improve the hydropower licensing process and to strengthen energy infrastructure through federal backstop transmission siting authority. The bill was strongly supported by the American Public Power Association, of which Metropolitan is a member. Metropolitan anticipates that the changes in law regarding hydropower licenses will prove beneficial in the Oroville relicensing process.