

- General Counsel's August 2006 Activity Report

Summary

This report discusses significant matters in which the Legal Department was involved during the month of August 2006.

Attachments

None.

Detailed Report

1. Litigation/Claims To Which Metropolitan Is A Party

a. *Protect Our Water and Environmental Rights (POWER) v. Imperial Irrigation District (IID)*
(State All-American Canal Case)

On August 28, 2006, the San Francisco Superior Court in *POWER v. IID* sustained the demurrers of Metropolitan, Imperial Irrigation District (IID), and San Diego County Water Authority to the plaintiffs' complaint. This Order terminates the litigation in favor of Metropolitan and the other water agencies. The plaintiffs had alleged that IID violated CEQA in commencing the All-American Canal Lining Project. The Court's Order dismissed the case, with no ability of plaintiffs to amend their complaint to overcome its defects, because (1) the United States had important interests at stake, and had to be joined as a party but could not be because of federal sovereign immunity; and (2) the case should have been brought as a validation action but the 60-day statute of limitations for validation actions had run.

The Court's Order incorporates many of the arguments in Metropolitan's pleadings in support of the demurrer. The Order recognizes that the Federal government has "unique" interests in the case. At the hearing on the demurrer, Metropolitan's argument pointed to the trust relationship that the United States has to the Indian Bands, and stated that the state water agencies can't stand in the shoes of the Federal government to fulfill this trust duty. Therefore, the Federal government was a necessary party to the litigation. The petitioners have the right to appeal this decision.

2. Other Matters Involving Metropolitan

a. *Consejo de Desarrollo Economico de Mexicali v. United States* (Federal All-American Canal Lining Case)

On August 24, 2006, the Ninth Circuit issued an injunction against work on the All-American Canal Lining project pending a decision by the Ninth Circuit on the legal challenges to the project. The Ninth Circuit also directed that oral argument on those legal challenges be scheduled during the week of December 4, 2006. Previously, the Federal district court in Las Vegas rejected legal challenges to the AAC Lining Project, and refused to issue an injunction against the project while the district court's decision was on appeal to the Ninth Circuit.

b. *Center for Biological Diversity v. U.S. Bureau of Reclamation* (*Glen Canyon Dam*)

Metropolitan and Imperial Irrigation District recently filed a joint motion to intervene in this case because of the importance of Glen Canyon Dam operation in maintaining a reliable water supply

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on the Colorado River. Motions to intervene were also filed by Central Arizona Water Conservation District, Colorado River Energy Distributors Association, the States of Colorado and Nevada, and the Southern Nevada Water Authority. Plaintiffs in the action contend that the Bureau is in violation of the Grand Canyon Protection Act as well as the Endangered Species Act (ESA) and National Environmental Policy Act (NEPA) and have asked the court to order the Bureau to prepare a supplemental Environmental Impact Statement under NEPA and to engage in a formal consultation with the U.S. Fish & Wildlife Service under Section 7 of the ESA.

Since the filing of the intervention motions, the plaintiffs and the Bureau have reached a tentative settlement that would result in dismissal of the action. The United States has agreed to prepare additional environmental documentation and to formally consult with USFWS on a mutually agreed upon schedule and plaintiffs have agreed to drop the Grand Canyon Protection Act action. The settlement should not impact dam operations in a manner that would affect supply. In an effort to preserve their ability to participate in the case, should the court make further orders that could affect supply issues, the parties moving to intervene have requested the court to grant them intervenor status should the court exercise further jurisdiction in the case. The court is expected to consider the proposed settlement terms and decide the pending intervention questions in late September or early October.

c. Electric Industry Restructuring

On August 2, 2006, the United States Court of Appeal for the Ninth Circuit issued its long-awaited decision in *California Public Utilities Commission v. Federal Energy Regulatory Commission*, completing appellate review of the initial series of appeals arising out of FERC orders establishing liability for refund of excessive charges from sales to the California Independent System Operator (CAISO) and the California Power Exchange (CAPX) during California's 2000-2001 energy crisis. The Ninth Circuit previously held that FERC exceeded its Federal Power Act authority when it subjected the energy sold by publicly owned electric utilities to the CAISO or CAPX to refund liability. (*Bonneville Power Administration v. Federal Energy Regulatory Commission*, 422 F.3d 908 (2005)). The recent *CPUC* decision addressed whether certain categories of energy sales to the CAISO/CAPX should be subject to refund, and generally upheld FERC's earlier determinations. The State Water Contractors and Metropolitan, together with other publicly owned utilities, unsuccessfully challenged FERC's decision to impose refund liability on transactions initiated by the CAISO requesting that publicly owned utilities purchase energy for the CAISO from third party suppliers because the suppliers wouldn't sell energy directly to the CAISO due to credit concerns. However, the *CPUC* opinion will have no effect on either Metropolitan or the State Water Project unless the *BPA* decision is reversed on rehearing or by the U.S. Supreme Court since *BPA* holds that FERC cannot subject sales by publicly owned utilities to refund liability. Concurrent with its issuance of the *CPUC* opinion, the Ninth Circuit issued an order extending by 45 days the deadline for submission of requests for rehearing, to allow time for settlement discussions.

d. California Public Utilities Commission Proceedings

On July 31 and August 18, 2006, Metropolitan staff submitted initial and reply comments in a proceeding initiated to consider whether the California Public Utilities Commission (CPUC) should permit investor-owned utilities (IOUs) to fund indirect energy savings achieved through water conservation. Currently, the CPUC will only permit IOU funding of activities that lead to direct energy savings. In recognition of the significant consumption of energy associated with water conveyance, treatment and distribution, the California Energy Commission's 2005

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Integrated Energy Policy Report recommended that the CPUC recognize embedded energy savings through water conservation. If the CPUC authorizes such recognition, Metropolitan may be able to significantly increase available funds for water conservation programs. All parties submitting comments supported CPUC recognition of embedded energy savings for the 2009-2011 funding cycle, and most parties support partial implementation in the current (2006-2008) funding cycle.

3. Matters of Interest Not Involving Metropolitan

a. Litigation Regarding State Water Resources Control Board Cease and Desist Order

The Department of Water Resources (DWR) and State Water Resources Control Board (SWRCB) agreed again to extend their tolling agreement until September 8, 2006 to allow additional discussions related to State Board's cease and desist order against DWR and USBR in February 2006. DWR has authority to initiate litigation if the settlement discussions fail. Existing cases filed by the SWC, Central Valley Project and by the United States have not been moving forward pending the DWR-SWRCB discussions.

4. Finances

Metropolitan closed the sale of \$300 million Water Revenue Bonds (including \$200 million fixed rate bonds and \$100 million auction rate securities) to provide funds for capital investment projects on August 23, 2006. The Legal Department worked with outside bond counsel to provide the disclosure to potential investors, financing documents and closing documents.