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9 CHINO BASIN WATERMASTER

10 SUPERIOR COURT OF THE STATE OF CALIFORNIA  
11 FOR THE COUNTY OF SAN BERNARDINO

12 CHINO BASIN MUNICIPAL WATER  
13 DISTRICT

14 Plaintiff,

15 vs.

16 CITY OF CHINO, ET AL.

17 Defendant.

Case No. RCV 51010

[Assigned for All Purposes to the  
Honorable JOHN P. WADE]

NOTICE OF MOTION FOR APPROVAL  
OF TEMPLATE STORAGE AND  
RECOVERY AGREEMENT

Hearing Date: August 11, 2009  
Time: 9:30 a.m.  
Dept: S32

18 TO ALL PARTIES AND THEIR COUNSEL OF RECORD:

19 PLEASE TAKE NOTICE that on August 11, 2009, at 9:30 am, at the above entitled Court,  
20 CHINO BASIN WATERMASTER (Watermaster) will move the Court to approve the Template  
21 Storage and Recovery Agreement, as approved by the Watermaster's Advisory Committee and  
22 Board on June 25, 2009. This request will be based upon Watermaster's Motion, as well as  
23 testimony presented at the August 11, 2009 hearing.

24 Dated: July 20, 2009

BROWNSTEIN HYATT FARBER SCHRECK, LLP

25 By:   
26

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Attorneys for  
CHINO BASIN WATERMASTER

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MOTION FOR APPROVAL OF  
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18  
19 This Motion requests approval of a Template Storage and Recovery Agreement. Section  
20 8.1(c) of Watermaster's Rules and Regulations requires that any Storage and Recovery Agreement  
21 must receive Court's approval in order to be valid.

22 Such approval provides a final level of oversight to the Watermaster process to ensure that  
23 the activities of Watermaster are consistent with the 1978 Judgment and the numerous agreements  
24 and programs that are built upon the Judgment. While the Template Agreement that is the subject of  
25 this Motion has received an extensive discussion through the Watermaster process, that process is  
26 consensus-based and democratic. The Court approval requirement allows any individual party to  
27  
28

1 raise legal or technical concerns if that party believes those concerns were not adequately addressed  
2 through the Watermaster process.

3 The Template Storage and Recovery Agreement was approved by the Appropriative Pool and  
4 the Overlying (Non-Agricultural) Pool ("Non-Agricultural Pool") on June 11, 2009. The Overlying  
5 (Agricultural) Pool ("Agricultural Pool") considered the Agreement on June 16, 2009, and voted to  
6 take no action. The Advisory Committee and the Board approved the Template Agreement on June  
7 25, 2009, with the Agricultural Pool members abstaining from each vote. On July 7, 2009,  
8 Watermaster provided notice to the parties that this Motion would be heard at the August 11, 2009  
9 hearing. A draft of this Motion was distributed to active parties via email on the afternoon of July  
10 14, 2009, and was available at a noticed workshop held by Watermaster on July 16, 2009 to discuss  
11 issues concerning the Template Storage and Recovery Agreement. Watermaster's counsel knows of  
12 no intended opposition to the Motion.  
13  
14

15 Watermaster hereby requests that the Court approve the Template Storage and Recovery  
16 Agreement attached hereto as **Exhibit A**.  
17

## 18 **I. BACKGROUND**

### 19 **1. Precedent Relevant to the Motion**

20 While the Template Storage and Recovery Agreement implements and is connected with  
21 many other established programs and procedures in the Watermaster process, there are also elements  
22 that are unique. This section summarizes relevant issues that are unique to this Motion or for which  
23 there is only a small amount of prior precedent.

24 This Motion requests approval of a "template" storage agreement. Watermaster has used  
25 template-like agreements before, and is authorized to do so under Paragraph 28 of the Judgment:  
26

27 "Watermaster shall adopt, with the approval of the Advisory Committee,  
28 uniformly applicable rules and a standard form of agreement for storage of  
supplemental water, pursuant to criteria therefore set forth in Exhibit "I."

1           Upon appropriate application by any person, Watermaster shall enter into  
2           such a storage agreement; provided that all such storage agreements shall  
3           first be approved by written order of the Court, and shall by their terms  
4           preclude operations which will have a substantial adverse impact on other  
5           producers.”

6           Similar standard form agreements are still in use by Watermaster and are located in  
7           Watermaster’s Rules and Regulations as an Appendix. These most recent standard forms were  
8           approved by the Court on July 19, 2001. These agreements are different from the Template  
9           Agreement that is the subject of this Motion, and Paragraph 28 should not be read as a specific  
10          authorization for the kind of template agreement under consideration here. To the best of the  
11          knowledge of Watermaster’s General Counsel, the Court has not previously been asked to approve a  
12          template agreement such as the one here. Concurrently with this Motion, Watermaster has submitted  
13          a Proposed Order that it believes adequately protects any party’s right to challenge the final  
14          agreement if it materially differs from the Template Agreement as approved by the Court. (See  
15          Proposed Order dated August 11, 2009, finding number (3).) This issue is discussed in greater detail  
16          below in section II.2.

17          The reason that the Template Storage and Recovery Agreement has been submitted to the  
18          Court as a template, rather than a final agreement, is because the Template Agreement is the  
19          agreement that will implement an auction of water that is currently held in storage in the Basin. The  
20          auction is described in greater detail in section I.5., below. To the best of the knowledge of  
21          Watermaster’s General Counsel, an auction such as this has never been conducted in the Chino  
22          Basin, though water auctions have recently occurred in other geographic areas where markets exist  
23          for water rights.<sup>1</sup>

24          Storage and Recovery Agreements, and the projects that are implemented with them, require  
25          a great deal of time and effort to create, manage and complete. For this reason, only four such  
26          agreements have previously been submitted for approval to the Court, all between Watermaster or  
27          other Chino Basin parties and the Metropolitan Water District of Southern California. The most

28          <sup>1</sup> See e.g. Town of Prescott Valley Water Auction (2007), in which 2,724 acre-feet of treated effluent  
          interests sold at a winning price of \$24,650 per acre-foot (\$67 million); see also the 2006 GASP  
          (Groundwater Appropriators of the South Platte River Basin, Inc.) auction in Colorado.

1 recent of these was the "Dry-Year Yield Agreement." This Agreement was approved in two parts  
2 with the first approved by the Court in an Order dated June 5, 2003 (Order Concerning Groundwater  
3 Storage Program Funding Agreement – Agreement No.49960) and the second in an Order dated  
4 June 24, 2004 (Order Approving Storage and Recovery Program Storage Agreement Re  
5 Implementation of Dry Year Yield Storage Project).

6 **2. "Storage" in the Chino Basin**

7 The Judgment recognizes that the Chino Basin contains a substantial amount of available  
8 groundwater storage capacity. (See Judgment, Paragraph 11.) Groundwater storage capacity is  
9 space in the groundwater basin (i.e., underground) that could hold water, but which is currently  
10 dewatered. Most of the groundwater storage capacity in the Chino Basin is the result of past over-  
11 pumping that lowered the groundwater table.

12 Groundwater storage in the Chino Basin is sufficiently important that two of the nine  
13 Optimum Basin Management Program ("OBMP") program elements are devoted to it: Program  
14 Element 8 – Develop and Implement Groundwater Storage Management Program, and Program  
15 Element 9 – Develop and Implement Storage and Recovery Programs.

16 **3. Storage and Recovery Program**

17 At the August 11, 2009 hearing, Watermaster will present testimony to describe each of  
18 Program Elements Eight and Nine in detail. In addition, some of the rules governing Storage and  
19 Recovery Program Agreements are described in this section.

20 In order to ensure the coordinated management of groundwater storage in the Chino Basin,  
21 the Judgment provides that, "It is essential that said reservoir capacity utilization for storage and  
22 conjunctive use of supplemental water be undertaken only under Watermaster control and regulation  
23 . . . ." (Judgment, Paragraph 11.) Pursuant to this mandate, Watermaster allocates the storage  
24 capacity in the Basin to various parties and programs in accordance with the Judgment and with  
25 rules and policies developed through consensus of the parties.

26 Section 5.2 of the June 2000 Peace Agreement describes some of the rules governing  
27 Watermaster's administration of storage. Peace Agreement section 5.2 addresses both "Local  
28 Storage" (5.2(b)) and the Storage and Recovery Program (5.2(c)). Local Storage is the name given

1 to storage accounts held by parties to the Judgment, and the Storage and Recovery Program is the  
2 program through which non-parties may also store water in the Basin. Storage is also governed by  
3 Watermaster's Rules and Regulations, Article VIII.

4 The Peace Agreement requires Watermaster to prioritize its efforts to regulate and condition  
5 the storage and recovery of water developed in a Storage and Recovery Program to mutually benefit  
6 the parties to the Judgment, and to give first priority to Storage and Recovery Programs that provide  
7 broad mutual benefits. (Peace Agreement, section 5.2(c)(iv)(b).) The Peace Agreement does not  
8 define "mutually benefit" and "broad mutual benefit."

9 The Peace Agreement also requires that any potential or threatened Material Physical Injury  
10 to any party to the Judgment or to the Basin that is caused by the storage and recovery of water,  
11 whether local storage or pursuant to a Storage and Recovery Program, shall be reasonably and fully  
12 mitigated as a condition of approval. (Peace Agreement, section 5.2(c)(xiii).) The requirement that  
13 Watermaster ensures that Material Physical Injury does not occur is the modern articulation of the  
14 mandate in Paragraph 28 of the Judgment (quoted above), that Watermaster ensure that storage  
15 agreements shall preclude operations which will have a substantial adverse impact on other  
16 producers. Material Physical Injury with respect to the Template Agreement is discussed in greater  
17 detail below in section II.3.a.

18 The Judgment Exhibit "I" Paragraph 3, contains the general requirements for any storage  
19 agreements:

20  
21 "3. Ground Water Storage Agreements. Any agreements authorized by  
22 Watermaster for storage of supplemental water in the available ground  
water storage capacity of Chino Basin shall include, but not limited to:

- 23 (a) The quantities and term of the storage right.  
24 (b) A statement of the priority or relation of said right, as against overlying  
or Safe Yield uses, and other storage rights.  
25 (c) The procedure for establishing delivery rates, schedules and procedures  
which may include

26 [1] spreading or injection, or

[2] in lieu deliveries of supplemental water for direct use.

- 27 (d) The procedures for calculation of losses and annual accounting for  
water in storage by Watermaster.  
28

(e) The procedures for establishment and administration of withdrawal schedules, locations and methods.”

#### 4. Peace II Measures

The “Peace II Measures” were approved by the Court on December 21, 2007. One of these measures is an agreement known as the “Purchase and Sale Agreement for the Purchase of Water by Watermaster From the Overlying (Non-Agricultural) Pool” (hereinafter “Purchase and Sale Agreement”). A copy of the Purchase and Sale Agreement is attached hereto as **Exhibit B**.

Pursuant to the Purchase and Sale Agreement and the Court’s approval, Watermaster will purchase water that members of the Non-Agricultural Pool have accumulated in storage. This water has accumulated in storage because, for many years, the rights available to members of the Non-Agricultural Pool have been greater than their demand. When a party does not pump all of its rights, the surplus water is considered to be put in storage and is available for pumping in subsequent years. (Judgment, Exhibit “G” Paragraph 7.) At the time of the Peace II Agreement, approximately 40,000 acre-feet of water had been accumulated by various members of the Non-Agricultural Pool. This water was not being efficiently utilized because it is not anticipated that the demand for water by the members of the Non-Agricultural Pool will ever increase to the point where the water would be needed by the Pool members.

Peace II authorized Watermaster’s acquisition of this stored water on behalf of the members of the Appropriative Pool to be used for either of two purposes: (1) desalter replenishment, and/or (2) implementation of storage and recovery agreements. The Non-Agricultural Pool dedicated ten percent of this water (4,000 acre-feet) for desalter replenishment. The other 36,000 acre-feet is currently planned to be used as part of a Storage and Recovery Program by way of an auction.

#### 5. Description of Auction Concept and Stakeholder Process Regarding Development

For several months, the members of the Appropriative Pool have been discussing the issue of how best to utilize the water purchased through the Purchase and Sale Agreement. The Pool established a subcommittee that met and discussed the idea independently of Watermaster staff. The

1 Pool has proposed to sell the water at auction with the proceeds to be used to finance capital  
2 improvements required under the updated Recharge Master Plan (see below, section II.3.b.).

3 In order to maximize the value to be received at the auction, the water will be packaged with  
4 the storage space that the water currently occupies. That is, the purchaser of the water will also  
5 receive a storage account that can be used after the currently stored water is extracted.

6 With direction from the Appropriative Pool, on June 25, 2009, the Advisory Committee and  
7 the Board approved the Template Storage and Recovery Agreement to serve as the legal instrument  
8 that defines the subject matter of the auction. This Template Agreement, along with an attached list  
9 of conditions (Attachment "A" of the Template Storage and Recovery Agreement), defines those  
10 storage and recovery related activities that the successful bidder(s) will be able to perform without  
11 further Watermaster's approval. Both the Template Storage and Recovery Agreement and the  
12 approved conditions are attached hereto as **Exhibit A**. Any activities that fall outside of those listed  
13 in the Template Agreement and the Attachment, would require further approval by Watermaster.

## 14 15 **II. APPROVAL OF TEMPLATE STORAGE AND RECOVERY AGREEMENT**

### 16 **1. Standard of Review**

17 Watermaster has only requested Court approval for a storage agreement under the OBMP's  
18 Storage and Recovery Program once before.<sup>2</sup> That motion was approved by Orders of the Court  
19 dated June 5, 2003, and June 24, 2004. In the June 5, 2003 Order, the Court found that the Court's  
20 review of storage agreements under the Storage and Recovery Program occurs pursuant to Paragraph  
21 31 of the Judgment. Under Paragraph 31, the Court's review is *de novo*.

22 Watermaster believes that the Court should look to the proposed Agreement and inquire  
23 whether the Agreement is consistent with the principal Watermaster's documents: the Judgment, the  
24 Peace I and II Agreements, prior orders of the Court, and the OBMP. Since these source documents  
25 devolve from the Judgment as a *stipulated* judgment, the Court's inquiry should be guided by  
26 objection from the parties. That is, in the event of a contested hearing, the Court should look at the

27  
28 <sup>2</sup> The OBMP was adopted along with the Peace Agreement in 2000. Previous storage agreements  
were not approved specifically under the OBMP Storage and Recovery Program.



1 issue *de novo*, and give Watermaster's findings and conclusions their appropriate weight. But so  
2 long as no party raises an issue through objection to Watermaster's Motion, the Court should defer  
3 to the decision of the Advisory Committee and Board.

4 Watermaster knows of no objection to the Court's approval of the Agreement. Monte Vista  
5 Water District voiced objection at the Pool level, but there was no objection at the Advisory  
6 Committee or Board. The Agricultural Pool abstained at all votes.

## 7 **2. Presented Agreement As a "Template"**

8 Watermaster seeks approval of a "template" agreement because potential bidders at the  
9 auction will demand to have an established framework for the commodity they will be attempting to  
10 purchase. However, different bidders may have different requirements, and Watermaster will not be  
11 able to finalize the agreement until Watermaster has concluded negotiations with successful bidders.  
12 So long as the final contract fits within the framework established by the Template Agreement,  
13 bidders can be assured that their intended use will have been pre-approved by the Court.

14 Watermaster should be given discretion to deviate in the final agreement from the approved  
15 Template Agreement, if necessary. If any party feels that such deviations are material, then they  
16 should be given an opportunity to object and request Court review. Such review, however, should  
17 be limited to those items that have changed and whether the changes are material. If no such  
18 objection is brought within 30 days of Watermaster's approval of the final Agreement, then the right  
19 to object should be waived and the Agreement should be presumed approved without need for an  
20 additional hearing. The Proposed Order submitted concurrently with this Motion includes  
21 conditionality to require such notice. (See Proposed Order, finding number (3).)

## 22 **3. Watermaster Approval Issues**

23 Given the origin of the Template Storage and Recovery Agreement in the Court-approved  
24 Peace II Documents, Watermaster's staff and legal counsel believe that the only two findings  
25 required to be made by the Board were whether the Template Storage and Recovery Agreement  
26 might result in physical harm to the Basin and whether the benefits will be appropriately spread  
27 amongst the parties. Thus, in approving the Agreement, Watermaster made findings that, as  
28

1 conditioned, the Template Agreement will not cause "Material Physical Injury" and the proceeds  
2 will be used for the broad mutual benefit.

3 **a. Material Physical Injury Analysis**

4 The Peace Agreement defines Material Physical Injury:

5  
6 "Material Physical Injury" means material injury that is attributable to the  
7 Recharge, Transfer, storage and recovery, management, movement or  
8 Production of water, or implementation of the OBMP, including, but not  
9 limited to, degradation of water quality, liquefaction, land subsidence,  
10 increases in pump lift (lower water levels) and adverse impacts associated  
11 with rising groundwater. Material Physical Injury does not include  
12 "economic injury" that results from other than physical causes. Once fully  
13 mitigated, physical injury shall no longer be considered to be material."  
14 (Peace Agreement section 1.1(y).)

15 Watermaster's staff found that because the water is already in storage in the Basin, approval  
16 of the Template Storage Agreement would not result in any changes to Basin conditions. A copy of  
17 the June 25, 2009 staff report and supplemental staff report is attached here as **Exhibit C**. In order  
18 to prevent future harm due to the withdrawal of the water from the storage, Watermaster's staff  
19 recommended a conditional approval whereby the purchaser of the water would be permitted to  
20 withdraw the water without a further review, so long as the Template Storage and Recovery  
21 Agreement is conditioned upon adherence to the Judgment, the Peace Agreement, and the  
22 requirement that the recovery of the water does not cause permanent subsidence. If these conditions  
23 are violated, then the withdrawal of the water may be further limited by Watermaster. The Proposed  
24 Order submitted concurrently herewith, includes conditionality consistent with staff's findings.  
25 (Proposed Order, finding number (1).)

26 **b. Broad Mutual Benefit**

27 On December 21, 2007, the Court issued an Order approving the "Peace II Measures." In  
28 addition to the Purchase and Sale Agreement described above, the Peace II Measures include a  
number of changes in Basin's management that Watermaster believes will have significant value for  
the Basin and for future generations.

1 One of the most innovative of these measures is the strategy known as "Basin Re-  
2 Operation." This strategy will be described in greater detail as a part of the August 11, 2009  
3 testimony concerning Program Element Seven (Salt Management). Briefly, Basin Re-Operation  
4 involves the lowering of water levels throughout the Basin in order to enhance the inflow of water  
5 from the Santa Ana River to the Basin. In future years, this strategy should result in more water for  
6 the Basin.

7 Re-Operation allows a certain amount of pumping from the Basin to occur without requiring  
8 replenishment. This process will occur slowly and deliberately, with constant monitoring by  
9 Watermaster to avoid unanticipated harm. Though Watermaster is confident that Re-Operation can  
10 be achieved without harm, it is concerned that the temporarily created surplus will cause demand to  
11 increase that will be dependant on groundwater pumping, without provision made for how that  
12 additional pumping will be replenished at the end of the period of Re-Operation when the temporary  
13 surplus is exhausted.

14 As a part of the Peace II Measures, Watermaster wanted to ensure that at the end of the  
15 period of Re-Operation, Watermaster would have the capacity to return the Basin to normal  
16 operating protocols where all over-production is replenished. Therefore, Peace II includes a  
17 commitment to update Watermaster's Recharge Master Plan to account for additional replenishment  
18 in advance of the conclusion of Re-Operation. (See OBMP Program Element 2.)

19 However, implementation of the Recharge Master Plan update will be very expensive.  
20 Given the current statewide budget situation, there are concerns with respect to its funding. This  
21 motion for approval of the Template Storage and Recovery Agreement is, therefore, conditioned  
22 upon the use of the auction proceeds to fund the Appropriative Pool's share of the recommended  
23 implementation items under the updated Recharge Master Plan. This use of the proceeds is  
24 specifically authorized by the Peace Agreement. (Peace Agreement, section 5.2(c)(vi).)

25 The Template Storage and Recovery Agreement was approved with conditions by the  
26 Watermaster's Advisory Committee and Board. To meet the broad mutual benefit standard,  
27 Watermaster conditioned its approval on a commitment that the revenues received from the auction  
28

1 that are in excess of the purchase price set forth in the Purchase and Sale Agreement be placed in an  
2 interest-bearing escrow account and earmarked by Watermaster for the following purpose:

3  
4 “Upon receipt of a written recommendation from the Appropriative Pool  
5 and further Board approval, Watermaster may authorize the use of excess  
6 revenues received from the Purchase and Sale Agreement for the  
7 Appropriative Pool share of capital improvements to be spread equitably  
8 among management zones and that are: (i) designed, approved and  
9 scheduled for timely implementation under the Court approved Recharge  
10 Master Plan or any approved yield enhancement/preservation program and  
11 (ii) will facilitate Watermaster’s recharge goals of maintaining hydrologic  
12 balance within each Management Zone and the Basin. “Capital  
improvements” means physical facilities that will be actually used in the  
production, storage, treatment and distribution of water that will recharge  
the Chino Basin, including but not limited to recharge basins, injection  
wells, pipelines and water supplies. The qualifying capital improvements  
may facilitate recharge directly or indirectly through approved in-lieu  
strategies.”<sup>3</sup>

13 There were no objecting votes, and the Agricultural Pool abstained from all votes. Pursuant  
14 to Sections 5.2(b)(xi) and 5.3(c)(iv) of the Peace Agreement, Watermaster must provide first priority  
15 to Storage and Recovery Agreements that will offer broad mutual benefits to the parties to the  
16 Judgment. In general, the members of the Non-Agricultural Pool and the Appropriative Pool are  
17 exclusively entitled to all the compensation received from storage and recovery agreements. (Peace  
18 Agreement, section 5.2(c)(v).) In the case of the Template Storage and Recovery Agreement, the  
19 members of the Non-Agricultural Pool will receive compensation, as set forth in the Purchase and  
20 Sale Agreement. The members of the Appropriative Pool will obtain the revenue received from any  
21 third party in excess of the purchase price under the Purchase and Sale Agreement and will use such  
22 revenues as described above. The Proposed Order submitted concurrently herewith includes  
23 conditionality to require the implementation of this proposed allocation of funds. (Proposed Order,  
24 finding number (2).)

25  
26  
27 <sup>3</sup> See June 25, 2009 staff report and supplemental staff report. This quotation contains revisions to  
28 the final language made through motion at the Advisory Committee and Board meetings and thus  
not reflected in the staff report or supplemental staff report.

1                   c.       **Export**

2           While “export” is not specifically defined by the Judgment, what is meant by the term is the  
3 physical removal of water from the Basin, as the Basin is defined by the Judgment in Exhibit “K.”  
4 When allocating storage capacity, Watermaster must give priority to the needs of the parties over  
5 exports. (Judgment, Paragraph 12.) Watermaster has adhered to this prioritization and today more  
6 than 200,000 acre-feet of water is stored within the Basin for local use.

7           The Judgment’s most significant discussion of export of water occurs in the Appropriative  
8 Pool Pooling Plan. (Judgment, Exhibit “H,” paragraph 7(b).) Exhibit “H” establishes a requirement  
9 that Watermaster replenish native water that is exported from the Basin by appropriators in excess of  
10 the amount that was being exported as of 1976.

11           This raises the question of whether it is permissible under the Judgment for the successful  
12 bidder to export the purchased water without incurring a replenishment obligation. This issue is  
13 important for the approval of the Template Storage Agreement because it will be a major  
14 consideration for any potential purchaser to know whether the water can be exported.

15           Watermaster believes that because of the particularities of this block of water, it is not  
16 subject to the replenishment obligation of Judgment Exhibit “H,” Paragraph 7(b).

17           The Judgment itself exempts certain exports from the replenishment requirement. Generally,  
18 the replenishment condition on exports was linked to the quantity of water physically exported in  
19 1976. Thus, the condition is not absolute even as it applies to the members of the Appropriative  
20 Pool. Watermaster staff’s view is that the purpose of the restriction is simply to protect the Basin’s  
21 safe yield and its historical forms of recharge.

22           In the instant case, the water in question derives from unused water stored by the Non-  
23 Agricultural Pool. The Pooling Plan for the Non-Agricultural Pool (Judgment, Exhibit “G”) does  
24 not contain an export limitation such as the one found in Exhibit “H.” The Judgment does not  
25 appear to have considered the question of exports with regard to the stored Non-Agricultural Pool  
26 water, which is reasonable since the Judgment also appears not to have anticipated the accumulation  
27 of Non-Agricultural Pool water in storage. As described above in section I.4., the reason that this  
28 water is available in the first place is because demand by the members of the Non-Agricultural Pool

1 is lower than the total rights adjudicated to the Pool and the Judgment did not provide a way for this  
2 surplus water to be used by other parties to the Judgment. The Peace Agreement sought a way to  
3 make this water available through an amendment to Exhibit "G" and the Peace II Agreement  
4 articulated the financial terms under which this water would become available to the members of the  
5 Appropriative Pool. The Peace II Agreement also proposed a mechanism to ensure that Non-  
6 Agricultural Pool water would not further accumulate in the future.

7 Thus, in response to a situation unanticipated by the Judgment, the parties by consensus have  
8 sought adjustments to the structure created by the Judgment in an effort to resolve the issue while  
9 preserving the Judgment's goal of protecting the historical forms of recharge to the Basin.

10 Watermaster believes that the proposal to use this water to raise funds to pay for improvements to  
11 the Basin recharge facilities is consistent with these efforts and consistent with the overall goals of  
12 managing the Basin pursuant to the OBMP. The proposal to allow the potential export of this single  
13 increment of water implements this proposal and, so long as it is not used as precedent for future  
14 proposals, should not cause any harm to the Basin or any party to the Judgment.

15 Watermaster requests that the Court make a finding that the water that is the subject of the  
16 Template Storage and Recovery Agreement can be available for export, but requests the Court to  
17 specify that this finding applies only to this increment of water and cannot be used as precedent for  
18 any future proposal involving export. Furthermore, any water placed into the storage accounts after  
19 withdrawal of the initial 36,000 acre-feet shall be subject to whatever export limitations exist for that  
20 new water independent of the Court's approval of the Template Storage and Recovery Agreement.  
21 The Proposed Order submitted concurrently herewith, contains such a conditional finding.  
22 (Proposed Order, finding number (4).)

### 23 24 **III. CONCLUSION**

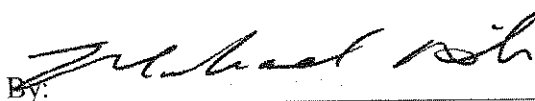
25 The Template Storage and Recovery Agreement implements the direction from the  
26 Appropriative Pool to use the water purchased through the Purchase and Sale Agreement in a way  
27 that will facilitate the financing of the capital projects to be described in Watermaster's updated  
28 Recharge Master Plan. Given the importance of the Recharge Master Plan, and the necessity to

1 implement the updates to this Plan to ensure the continued viability of the Physical Solution under  
2 the Judgment, Watermaster believes that the auction strategy is appropriate. Watermaster believes  
3 that the Agreement, as structured, complies with the Judgment, Peace Agreements I and II, Orders of  
4 this Court, and the OBMP.

5 On this basis, Watermaster respectfully requests the Court to approve the Template Storage  
6 and Recovery Agreement.

7  
8 Dated: July 20, 2009

BROWNSTEIN HYATT FARBER SCHRECK, LLP

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11 By: \_\_\_\_\_  
12 MICHAEL T. FIFE  
13 SCOTT S. SLATER  
14 Attorneys for  
15 CHINO BASIN WATERMASTER  
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# Exhibit A



**TEMPLATE  
STORAGE AND RECOVERY AGREEMENT  
DOES 1-4**

This Storage and Recovery Agreement is made by and between the Chino Basin Watermaster, a Court-appointed groundwater basin management entity ("Watermaster") and Does Number 1-4, and is effective as of the date last signed by a Party ("Effective Date"). The term "Buyer" as used herein shall refer to the buyer at Auction (as defined in Recital \_\_ herein). This Agreement shall govern all actions between Does 1-4 and Watermaster. Watermaster and Does Number 1-4 are sometimes referred to herein collectively as "Parties" and individually as "Party."

**RECITALS**

A. In 1978, the San Bernardino Superior Court entered judgment on Case No. 164327 (now designated No. RCV 51010), Chino Basin Municipal Water District v. City of Chino (the "Judgment"). The Judgment is a plenary adjudication of all rights to groundwater and storage capacity within the Chino Basin and established a physical solution to provide ongoing management of the Chino Basin water resources and an equitable and feasible method of allocating the cost of importing supplemental water to achieve a hydrologic balance within Chino Basin. The Judgment adjudicated the rights of several hundred overlying landowners as well as several substantial industrial and commercial producers of water for use on their overlying lands, and within the cities, public water districts, utilities, and mutual water companies that provide water service within and adjacent to the Chino Basin.

B. The Judgment authorized the appointment of a Watermaster with the express powers and duties as provided for in the Judgment or as the Court may subsequently order pursuant to its continuing jurisdiction. Watermaster holds no rights to produce groundwater, but is the entity responsible for monitoring and regulating the production of groundwater within the Basin under the Judgment.

C. Each of the defendants named in the Judgment is a water producer or other water claimant or public water district within the Chino Basin. Each such defendant has been identified as a member of one of the following three groups: (1) Overlying (Agricultural) Producers, possessing lands overlying the Chino Basin and producing water from the Basin for agricultural uses on overlying lands; (2) Overlying (Non-Agricultural) Producers (the "Non-Ag Pool"), possessing lands overlying Chino Basin, producing water from the Basin for use on overlying lands for other than agricultural purposes; and (3) Appropriators, producing water from Chino Basin pursuant to appropriative or prescriptive rights.

D. On June 29, 2000, the Non-Ag Pool entered into the Chino Basin Peace Agreement ("Peace Agreement") with various other Chino Basin right holders. The Peace Agreement enabled Watermaster to adopt and implement the Optimum Basin Management Program ("OBMP"), a comprehensive program to monitor, develop, and manage groundwater

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and storage capacity in the Chino Basin. The Peace Agreement grants Watermaster significant authority to regulate storage and recovery programs in the Chino Basin. Specifically, Section 5.2(a)(i) provides that "all storage capacity shall be subject to regulation and control by Watermaster." Under Section 5.2(c)(ix), Watermaster "reserves complete discretion" over any proposed storage and recovery program involving non-parties to the Judgment. Additionally, Section 5.3(e) provides that "parties to the Judgment with rights within the [Non-Ag Pool] shall have the additional rights to Transfer their rights to Watermaster for the purposes of Replenishment for a Desalter or for a Storage and Recovery Program."

E. Exhibit B to the Peace Agreement was the Implementation Plan: Optimum Basin Management Program ("Implementation Plan") and the Court ordered Watermaster to proceed in accordance with the Peace Agreement and Implementation Plan in its Order of July 13, 2000 (July 13, 2000 Order, p.4.).

F. Program Element 8 of the OBMP Implementation Plan set forth a strategy for the development of groundwater storage. Program Element 9 of the Implementation Plan set forth a plan for developing and implementing a Storage and Recovery Program.

G. The Implementation Plan (page 38) set forth the baseline against which storage activities would be evaluated and that "Safe Storage is an estimate of the maximum storage in the Basin that will not cause significant water quality and high groundwater related problems;" and further set forth the baseline for "Safe Storage Capacity" within which Watermaster could safely approve further storage and recovery without causing water quality degradation and high groundwater related problems and estimated the quantity of Safe Storage Capacity at 500,000 acre-feet, "including water in the existing storage accounts."

H. The Inland Empire Utilities Agency ("IEUA") certified the Programmatic Environmental Impact Report ("PEIR") for Watermaster's Optimum Basin Management Program on July 12, 2000. This PEIR analyzed the impacts associated with a 100,000-300,000 acre-foot storage and recovery program and found no significant impacts from such a program.

I. On October 25, 2007, the Non-Ag Pool entered into the Chino Basin Peace II Agreement ("Peace II") with various other Chino Basin right holders to confirm support for Watermaster's OBMP. As part of Peace II, Exhibit G to the Judgment was amended to grant members of the Non-Ag Pool "the discretionary right to transfer or lease their quantified production rights and carry-over water held in storage accounts to Watermaster in conformance with the procedures described in the Peace Agreement between the parties therein." On the same date, Paragraph 8 of the Judgment was similarly amended to grant members of the Non-Ag Pool the "right to transfer or lease their quantified production rights to Watermaster in conformance with the procedures described in the Peace Agreement between the parties therein." In conjunction with Watermaster's "complete discretion" under the Peace Agreement to enter into Storage and Recovery Programs with non-parties to the Judgment, these Peace II amendments authorize Watermaster to purchase or lease water rights from the Non-Ag Pool to remarket those

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rights to other entities such as Does Number 1-4.

**J.** Watermaster has sold by auction the sole and exclusive contractual right and interest to certain Chino Basin related Groundwater Resources in conformity with the Judgment and the Peace Agreement(s).

**K.** An applicant for approval of a Storage and Recovery Agreement must comply with the approved forms in accordance with Appendix 1 to the Rules and Regulations and the proposed forms require the statement of compliance with the requirements of the California Environmental Quality Act.

**L.** Despite the inability to presently identify the successful bidder at the auction (Buyer) Watermaster seeks to establish pre-approved parameters to enable it to conduct an auction regarding a certain and defined Overlying (Non-Agricultural) Pool stored water supply and a Storage and Recovery Agreement and to present this Template Agreement to the Court for approval.

**M.** A template application has been approved by the Advisory Committee and the Board and no opposition was expressed to the proposed application for a Storage and Recovery Agreement. The date of approval by the Advisory Committee and Board was June 25, 2009 and Watermaster is prepared to execute a Storage and Recovery Agreement in accordance with the conditions of approval and the Judgment following the conclusion of a successful auction.

**NOW, THEREFORE,** in consideration of the mutual promises, covenants, and agreements hereinafter set forth, and for other good and valuable consideration (the receipt and sufficiency of which are hereby acknowledged), the Parties agree as follows:

**1. Incorporation by Reference.** The above Recitals and Exhibits hereto are incorporated herein by this reference.

**2. Purpose.** This Template Storage and Recovery Agreement will be used for the purpose of obtaining Court Approval of the auction of 36,000 acre-feet in 4 lots of 9,000 acre-feet each along with a cumulative total of 40,000 acre-feet of storage capacity in lots of 10,000 acre-feet respectively. Upon completion of the auction process, each of the 4 Template Storage and Recovery Agreements will be amended to identify the successful Buyer and substituted for Doe(s) 1-4 and *prior to execution*, the Agreement will be further conformed as may be deemed prudent and necessary to effectuate the intent of the Parties.

**3. Regulation of Water in Storage.** Buyer acknowledges that any Storage and Recovery of water under this Agreement shall occur only under Watermaster's control and regulation in accordance with the Judgment and the Peace Agreement. However, Watermaster agrees that the Watermaster's Storage and Recovery Policies shall be applied to water stored pursuant to this Agreement in a non-discriminatory manner consistent with the application of

Template Agreement

such policies to any other participant in the Storage and Recovery Program, including all parties to the Judgment. Watermaster shall not impose any policies upon the water stored pursuant to this Agreement, whether or not imposed on other parties that would materially alter the rights or benefits provided to the Buyer under the auction. Without limiting the foregoing, Watermaster shall not impose any policies that would create any significant discrepancies between the amount of water placed into storage and the amount of water that is available for recapture.

**4 Quantity of Storage Right.** Subject to the terms of this Agreement, Buyer may store up to 10,000 acre-feet of water within the Safe Storage Capacity of the Chino Basin.

**5. No Material Physical Injury.** The Storage and Recovery of 9,000 acre-feet of stored Overlying (Non-Agricultural) Pool water, Supplemental Water and other water stored under this Agreement will not cause Material Physical Injury or a substantial adverse impact to any party to the 1978 Judgment or to the Basin itself provided that the conditions set forth in Exhibit "A" are met.

**6. Watermaster Cooperation on Delivery of Supplemental Water to Storage.** Watermaster will exercise good faith and reasonable best efforts to make available any Watermaster controlled facilities for the purpose of assisting Buyer make deliveries of water into storage.

**7. Delivery and Withdrawal Maximums.** Subject to the conditions set forth in Exhibit A, there is no maximum rate of placement of water into or from storage.

**8. Export.** There is no limitation on the place of use for the initial 9,000 acre-feet secured through the auction or upon Supplemental Water that is subsequently stored.

**9. Priority of Rights.** Watermaster will take the necessary actions (including groundwater monitoring and mitigation and/or limiting extraction of groundwater) to protect the rights of the persons and entities with rights arising under the Judgment.

**10. Assignment of Storage Capacity.** Buyer's rights under this Agreement, inclusive of any claim to storage capacity, may be assigned with the prior approval of Watermaster, whose approval shall not be unreasonably withheld.

**11. Accounting.** Watermaster shall maintain records of the amounts of all water stored in and extracted from the Chino Basin pursuant to this Agreement and all other Storage Agreements and will not approve additional Storage Agreements if such approval(s) will result in more than 500,000 acre-feet of water being stored within the Basin at any time without further approval of Watermaster and the Court. Watermaster's accounting shall not include any credit for return flows from the use of water extracted from storage. Watermaster's accounting will include the assignment of losses according to a procedure utilized for all water stored in the Storage and Recovery Program.

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**12. Losses.** The quantity of water stored under the Agreement by Buyer shall be subject to the uniform losses established by Watermaster in a non-discriminatory manner.

**13. Term.** This Storage Agreement shall be effective upon approval of the Court and shall remain in effect for thirty (30) years.

**14. Conflicts.** All conflicts arising under this Agreement, without limitation shall be resolved by the Court pursuant to paragraph 15 of the 1978 Judgment.

**CHINO BASIN WATERMASTER**

**BUYER**

By: \_\_\_\_\_

By: \_\_\_\_\_

Dated: \_\_\_\_\_

Dated: \_\_\_\_\_

Approved as to Form:

Approved as to Form:

## **Exhibit A**

### **Conditions for Storage and Recovery Agreements**

#### **1. General Legal Conditions**

The storage and recovery of water in Chino Groundwater Basin is subject to legal conditions imposed by:

- Chino Basin Municipal Water District v. City of Chino (Sup. Ct. County of San Bernardino, No. 164327, 1978) (Judgment);
- Peace Agreement;
- Peace II Agreement
- The Optimum Basin Management Plan for the Chino Basin (OBMP);
- Prior Orders of the Court;
- The Court's continuing jurisdiction under the Judgment;
- Watermaster's regulation of storage as defined by the above listed documents and the Chino Basin Watermaster Rules and Regulations.

#### **2. No Material Physical Injury**

(a) Permitted Withdrawals: No significant changes in groundwater quality are expected from the uses listed below.

- Storage – The AFA Party would obtain a storage account pursuant to the AFA and place the water in storage for subsequent use.
- Use by a Judgment Party to offset a replenishment obligation pursuant to the Judgment – The AFA Party would, by means provided for in the Judgment and the Peace Agreement, provide the water to a Judgment Party, and the Judgment Party would use the water to offset a replenishment obligation.
- Physical export of the water by an AFA Party or Judgment Party – The AFA Party or Judgment Party would produce the AFA Party's water through new or existing facilities and convey that water out of the Chino Basin through surface facilities for subsequent use on lands that do not overlie or are not tributary to the Chino Basin.
- Exchange export by a Judgment Party – The AFA Party would provide water to a Judgment Party, substituting that water for water that would otherwise be imported to the Basin; the avoided imported water would then be provided to some other non-Judgment entity at the direction of the AFA Party.

- (b) Restricted Withdrawals: Require Watermaster approval of a separate and detailed production proposal.
- No Subsidence. Proposed production of the stored water that may cause permanent subsidence.
  - Other unknown uses –Uses other than Permitted Withdrawals listed above in Section 2(a)..
3. Watermaster Oversight of Deposits into Storage. Purchaser shall exercise good faith and best efforts in coordinating further deposits into the Chino Basin with Watermaster.
4. Exports in Excess of initial 9,000 acre-feet subject to any water export limitations under the Judgment, the Peace Agreement, the OBMP, and Watermaster Rules and Regulations.

# Exhibit B



September 21, 2007

**Attachment "G"**

**PURCHASE AND SALE AGREEMENT FOR  
THE PURCHASE OF  
WATER BY WATERMASTER  
FROM OVERLYING (NON-AGRICULTURAL) POOL**

THIS AGREEMENT (Agreement) is dated 27th day of September, 2007, regarding the Chino Groundwater Basin.

**RECITALS**

**WHEREAS**, the Peace Agreement expressly authorized a transfer of water from the Overlying (Non-Agricultural) Pool to Watermaster for use as replenishment for the Desalters and for use in connection with a Storage and Recovery Program;

**WHEREAS**, Watermaster is evaluating its replenishment needs under the Judgment and several Storage and Recovery opportunities;

**WHEREAS**, Watermaster desires to purchase and the Overlying (Non-Agricultural) Pool desires to sell, all of the Non-Agricultural Pool water held in storage as of June 30, 2007;

**WHEREAS**, Watermaster is proposing an amendment to the Overlying (Non-Agricultural) Pool Pooling Plan set forth in Exhibit "G" to the Judgment whereby members of the Pool may offer water for purchase by Watermaster and thence the members of the Appropriative Pool under the process set forth therein;

**NOW THEREFORE**, in consideration of the mutual promises specified herein and by conditioning their performance under this Agreement upon the conditions precedent set forth herein, and for other good and valuable consideration, the Parties agree as follows:.

**A. Peace Agreement Transfer.** This purchase and sale agreement is in accordance with Section 5.3(e) of the Peace Agreement that provides that "parties to the Judgment with rights within the Non-Agricultural (Overlying) Pool shall have the additional rights to Transfer their rights to Watermaster for the purposes of Replenishment for a Desalter or for a Storage and Recovery Program."

**B. Quantity.** The quantity of water being made available to Watermaster by the Non-Agricultural (Overlying) Pool on a one-time basis ("Storage Transfer Quantity") is equivalent to the total quantity of water held in storage by the members of the Overlying (Non-Agricultural) Pool held in storage on June 30, 2007 ("Storage Quantity"), less a ten percent dedication for the purpose of Desalter Replenishment, less the quantity of water transferred pursuant to paragraph I below ("Special Transfer Quantity").

September 21, 2007

C. **Notice.** Within twenty-four months of the final Court approval of this Agreement ("Effective Date"), and only with the prior approval of the Appropriative Pool, Watermaster will provide written **Notice of Intent to Purchase** the Non-Agricultural (Overlying) Pool water pursuant to Section 5.3(a) of the Peace Agreement, which therein identifies whether such payment will be in connection with Desalter Replenishment or a Storage and Recovery Program.

D. **Payment.** Commencing thirty (30) calendar days from the Notice of Intent to Purchase ("Payment Date") Watermaster will pay to the Non-Agricultural Overlying Pool for each acre-foot of the Storage Transfer Quantity in accordance with the following schedule as the schedule is adjusted for inflation by the consumers price index ("cpi") for San Bernardino County from May 31, 2006 until the Payment Date.:

1. \$215 times 1/4 of the Storage Transfer Quantity on the Payment Date.
2. \$220 times 1/4 of the Storage Transfer Quantity on the first anniversary of the Payment Date.
3. \$225 times 1/4 of the Storage Transfer Quantity on the second anniversary of the Payment Date
4. \$230 time 1/4 of the Storage Transfer Quantity on the third anniversary of the Payment Date.

However, all payments provided for herein, including inflation adjustments, are subject to an express price cap and will not exceed ninety-two (92) percent of the then prevailing MWD replenishment rate in any year.

E. **Dedication to Desalter Replenishment.** Upon Watermaster's issuance of its written **Notice of Intent to Purchase**, and Watermaster's tender of its initial payment on the Payment Date, ten (10) percent of the Storage Quantity will be dedicated for replenishment of Desalter production without compensation. Watermaster will receive but will not pay for this dedication.

F. **Use and Distribution.** Watermaster will take possession of the water made available pursuant to this Agreement and make use of and distribute the water made available in a manner consistent with Section 5.3(e) of the Peace Agreement.

G. **Condition Precedent.** This Agreement and the Parties performance hereunder are expressly conditioned upon Court approval of this Agreement.

H. **Early Termination.** This Agreement will expire and be of no further force and effect if: Watermaster does not issue its **Notice of Intent to Purchase** in accordance with Paragraph D above within twenty-four (24) months of Court approval. Upon Watermaster's failure to satisfy the condition subsequent, the rights of the Non-Agricultural (Overlying) Pool will remain unaffected and without prejudice as result of their having executed this Agreement except that in the event of Early Termination, the Storage Transfer Quantity, will then be made available for purchase by Watermaster and thence the members of the Appropriative Pool in accordance with Paragraph 9.(iv) of Amended Exhibit G, the Overlying (Non-Agricultural) Pool,

September 21, 2007

Pooling Plan, including the requirement of a ten percent dedication towards Desalter replenishment.

**I. One Time Transfer in Furtherance of the Physical Solution and in Aid of Desalter Replenishment ("Special Transfer Quantity").** In consideration of the Overlying (Non-Agricultural) Pool members' irrevocable commitment made herein and it the Peace II Measures Watermaster will purchase and immediately make available the quantity of 8,530 acre-feet (less a ten percent dedication to Watermaster for Desalter Production) to the San Antonio Water Company (SAWCO) and Vulcan Materials, a member of the Overlying (Non-Agricultural) Pool under terms established as between those parties. This One Time Transfer is in addition to and without prejudice to the discretionary rights of the members of the Overlying (Non-Agricultural) Pool to make available and Watermaster and members of the Appropriative Pool to purchase water as Physical Solution transfers. No member of the Appropriative Pool, other than SAWCO assumes any responsibility for the purchase of this Special Transfer Quantity from Vulcan.

IN WITNESS THEREOF, the Parties hereto have set forth their signatures as of the date written below:

Dated:

NON-AGRICULTURAL OVERLYING POOL

By \_\_\_\_\_

# Exhibit C



## CHINO BASIN WATERMASTER

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KENNETH R. MANNING  
Chief Executive Officer

### SUPPLEMENTAL STAFF REPORT

**DATE:** June 25, 2009

**TO:** Advisory Committee Members  
Watermaster Board Members

**SUBJECT:** Non-Agricultural Pool Stored Water Auction

#### Background:

This Staff Report supplements the Staff Report initially distributed to the Appropriative Pool on June 15, 2009, and further revised on June 25, 2009. This Supplemental Staff Report addresses specific issues that were raised in the Pool meetings. Specifically, this Supplemental Staff Report addresses the following issues:

1. The concern that emphasis on localized subsidence problems in MZ1 may reduce participation by MZ1 stakeholders;
2. The justification for imposing a 2% storage loss on the auction water;
3. The establishment of minimum financial terms.

#### Issue 1: Material Physical Injury.

Watermaster has received comments expressing a concern that the initial Watermaster Staff Report and the Proposed Conditions on Recovery of Water within Management Zone 1 (MZ1), which require additional discretionary approvals, reduces the opportunity of west-end producers to receive the maximum benefit associated with the auction. Watermaster agrees and has revised both the earlier Staff Report submitted to the Pools and the Proposed Conditions to clarify that the true governor is avoiding permanent subsidence, not any localized limitation. Producers throughout the Basin should be able to receive the direct financial benefits associated with the auction (including the reduction of future costs) as well as a fair opportunity to participate in a future recovery program.

#### Issue 2: The Justification for Imposing a 2% Storage Loss.

Watermaster is authorized under the Judgment, Peace I, and Peace II to approve and execute storage and recovery agreements. In general, Watermaster is required to establish a 2% minimum loss requirement on all water in storage unless and until additional technical information suggests a more appropriate loss percentage. However, with regard to third parties that may desire to acquire a storage and recovery agreement, Watermaster must impose a 6% loss percentage unless it concludes that the circumstances warrant a relaxation of the loss requirement (under no circumstances less than 2%). Among the circumstances that warrant a relaxation of loss requirements is a Watermaster determination that the Party seeking a storage agreement has delivered "financially equivalent" consideration to offset the cost of past performance prior to implementation of the OBMP.

The uniform annual loss (leave behind) of six (6) percent will be applied to all storage accounts to address actual losses, management and equitable considerations arising from the implementation of the Peace Agreement, the OBMP Implementation Plan, the 2007 Supplement to the OBMP Implementation Plan, including but not limited to the desalters and Hydraulic Control unless the Party holding the storage account: (i) has previously contributed to the implementation of the OBMP as a Party to the Judgment, is in compliance with their continuing covenants under the Peace Agreement or in lieu thereof they have paid or delivered to Watermaster "financial equivalent" consideration to offset the cost of past performance prior to the implementation of the OBMP and (ii) promised continued future compliance with Watermaster Rules and Regulations. In the event that a Party satisfies 7.4(a)(i) and 7.4(a)(ii) they will be assessed a minimum loss of two (2) percent against all water held in storage to reflect actual estimated losses. Watermaster's evaluation of the sufficiency of any consideration or financial equivalency may take into account the fact that one or more Parties to the Judgment are not similarly situated.

(Peace II, Section 7.4(a).)

Thus, when Watermaster has determined under the circumstances that a finding of financial equivalency is warranted, Watermaster has discretion to set the applicable loss percentage between 6% and 2%.

In the instant case, the Storage and Recovery Agreement is being proposed in connection with the existing storage of Overlying (Non-Agricultural) Pool and the Purchase and Sale Agreement, which was a component of the Peace II measures. Watermaster staff recommends that the following rationale further supports its recommendations that a 2% storage loss percentage be used in connection with this Storage and Recovery Agreement.

- The stored water is presently *within* storage and the execution of the Storage and Recovery Agreement(s) will not occupy or pledge any new storage. Thus, a commonly held opportunity beyond the existing condition, excess storage capacity, will not be encumbered by the proposal.
- Watermaster does not anticipate incurring any new material expense in administering the Storage and Recovery Agreement(s). However, the annual payment received by Watermaster from the storing party will be new revenue that can offset ongoing costs and expenses as may be consistent with the Peace Agreement and the approved "Broad Benefit" standard.
- The stored water available to Watermaster under the Purchase and Sale Agreement may only be acquired for either (1) desalter replenishment; or (2) storage and recovery. This limits Watermaster's access to the stored water unless it couples its acquisition with a Storage and Recovery Agreement. Therefore, Watermaster may not auction/sell/transfer the stored water unless it also markets the supply with storage within the Basin (assuming it will not purchase the water for desalter replenishment). Therefore, the use of a lesser loss factor will increase the potential return to Watermaster and the stakeholders by increasing the relative value of the asset held for auction;
- The storage is being auctioned as a unit with 36,000 acre-feet of water. It is Watermaster staff's belief that the maximum return on investment for the water held in storage would be its utility as a dry-year supply. By allowing a potential purchaser the right to withdraw the water in a dry year, it maximizes the likelihood that the maximum return will be achieved. For example, MWD Tier-Two water rates are projected to exceed \$900 per acre-foot in 2010, with the MWD Tier-Two penalty rate at substantially higher. Consequently, the utilization of a 2% loss figure should result in a higher return for the unit. This should ensure a higher return for the unit. That is, a portion of the financial equivalent will be embedded in the relatively higher purchase price for the unit.
- The stored water made available under the Purchase and Sale Agreement is already subject to a 10% dedication for the benefit of desalter replenishment.

The overall magnitude of the transaction presents the prospect that if the minimum bid price (\$600) recommended by Watermaster staff is achieved, then a net return to Watermaster parties for the sale of water alone would exceed \$21 million. Coupled with the annual return on the administration of storage, approximately \$1 million per year, adjusted for inflation, Watermaster can achieve substantial Broad Benefit, *provided that* Watermaster uses the proceeds in the approved manner.

**Issue 3: Establish Minimum Financial Terms.**

From the inception of Watermaster's exploration of the Auction process, Watermaster staff has insisted on a minimum return of \$600 per acre-foot for the 36,000 acre-feet of water held in storage and a \$25 per acre-foot annual storage fee. Consistent with this historic processing of the auction proposal, Watermaster staff recommends that a minimum return (Reserve Price) of \$600 per acre-foot for the 36,000 acre-feet in storage, and \$25 per acre-foot for the administration of the storage account be in the Storage and Recovery Agreement. The Template Agreement included within the Advisory Committee and Board packet will be amended to reflect actual purchase price.

Staff's recommendation is that these minimum financial requirements be established to encourage the maximum bidder participation. The Board, with input from the Appropriative Pool, is free to subsequently set the auction requirements at any level it desires, so long as it remains higher than the identified minimums.



# CHINO BASIN WATERMASTER

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**KENNETH R. MANNING**  
Chief Executive Officer

## STAFF REPORT

**DATE:** June 11, 2009  
June 16, 2009  
June 25, 2009

**TO:** Committee Members  
Watermaster Board Members

**SUBJECT:** Non-Agricultural Pool Stored Water Auction

### SUMMARY

*Summary:* Action items required in order for the Non-Agricultural Pool stored water auction to move forward as reported and discussed at prior pool meetings.

*Recommendation:* Staff recommends: (1) adoption of proposed allocation of auction funds in order to provide broad mutual benefit; (2) adopt findings regarding potential for material physical injury; (3) approval of the draft storage and recovery agreement through an auction process; and (4) retain a qualified auction consultant, subject to approved terms.

### Background

One part of the Peace II Measures is the Purchase and Sale Agreement for the Purchase of Water by Watermaster from the Overlying (Non-Agricultural) Pool. (See Exhibit "G" to Watermaster Resolution 07-05 (Resolution 07-05 is Exhibit "1" to the Peace II Agreement).)

Section "C" of the Purchase and Sale Agreement says that within 24 months of the final Court approval of the Peace II Measures (December 21, 2007), Watermaster will provide written notice of intent to purchase the water held in storage by the Non-Agricultural Pool as of June 30, 2007. The amount of water held in storage by the Non-Agricultural Pool as of June 30, 2007 is approximately 40,000 acre-feet. Under section "E" of the Purchase and Sale Agreement, 10% of this quantity will be dedicated to desalter production without compensation to the Non-Agricultural Pool. Under section "F" of the Purchase and Sale Agreement, Watermaster will take possession of the remaining water and make use of the water in a manner consistent with Section 5.3(e) of the Peace Agreement.

Section 5.3(e) of the Peace Agreement says that members of the Non-Agricultural Pool may transfer or lease their quantified production rights within the Pool or to Watermaster to use for desalter replenishment or for use in the storage and recovery program. All transfers made under Peace Agreement Section 5.3 are subject to the requirements stated in 5.3(a) that no transfer shall be approved unless it is consistent with the Judgment and the Peace Agreement and will not cause Material Physical



Injury. In addition, under Peace Agreement section 5.2(c)(iv)(b), Watermaster will give first priority to Storage and Recovery Programs that provide broad mutual benefits.

Watermaster staff has been working with the members of the Appropriative Pool to develop a proposed approach for disposition of the water obtained through the Purchase and Sale Agreement. A proposal has emerged whereby a storage account containing the water will be put up for auction according to terms and conditions as described in the storage and recovery account agreement. Before the auction can take place, the Watermaster Board must approve its willingness to enter in to the storage and recovery agreement with the successful bidder, whoever that might be. Pursuant to the Peace Agreement, as a precondition to this Board action, the Board will also be required to find that the storage and recovery agreement will not cause Material Physical Injury, and must find that the agreement will provide broad mutual benefit. Staff recommendations regarding these finds as well as the storage and recovery agreement itself are described below.

## **1. Recommendation Regarding Broad Mutual Benefit**

As a precondition to Board and Court approval of the Storage and Recovery Agreement, there must be a finding that the program will provide broad mutual benefit. Pursuant to Sections 5.2(b)(xi) and 5.3(c)(iv) of the Peace Agreement, Watermaster must provide first priority to Storage and Recovery Agreements that will offer broad mutual benefits to the parties to the Judgment. The members of the Overlying (Non-Agricultural) Pool and the Appropriative Pool are exclusively entitled to all the compensation received from the Storage and Recovery Agreement. (Peace Agreement Section 5.2(c)(v).)

With regard to the Purchase and Sale Agreement with the Overlying (Non-Agricultural) Pool, the members of the Non-Ag Pool will receive the compensation as set forth in the Purchase and Sale Agreement. The members of the Appropriative Pool will obtain the revenue received from any third party in excess of the purchase price under the Purchase and Sale Agreement.

To meet the broad mutual benefit standard, Watermaster staff proposes that the revenues received from the auction that are in excess of the purchase price set forth in the Purchase and Sale Agreement be escrowed in an interest bearing account and earmarked by Watermaster for the following purpose:

**"Upon receipt of a written recommendation from the Appropriative Pool and further Board approval, Watermaster may authorize the use of excess revenues received from the Purchase and Sale Agreement for capital improvements to be spread equitably among management zones and that are: (i) designed, approved and scheduled for timely implementation under the Court approved Recharge Master Plan or any approved yield enhancement/preservation program and (ii) will facilitate Watermaster's recharge goals of maintaining hydrologic balance within each Management Zone and the Basin. "Capital improvements" means physical facilities that will be actually used in the production, storage, treatment and distribution of water that will recharge the Chino Basin, including but not limited to recharge basins, injection wells, pipelines and water supplies. The qualifying capital improvements may facilitate recharge directly or indirectly through approved in-lieu strategies."**

Watermaster staff recommends that the Pools recommend to the Advisory Committee and Board that approval of the auction storage and recovery agreement be conditioned upon the use of the auction proceeds consistent with the above proposal.

## **2. Material Physical Injury Analysis**

As a precondition to Board and Court approval of the Storage and Recovery Agreement, there must be finding that no unmitigated Material Physical Injury exists. Watermaster staff considered the following uses of the water being sold and stored pursuant to the proposed Auction Floor Agreement ("AFA") with respect to determining the potential for Material Physical Injury due to the proposed storage and recovery agreement:

- Storage – The AFA Party would obtain a storage account pursuant to the AFA and place the water in storage for subsequent use.
- Use by a Judgment Party to offset a replenishment obligation pursuant to the Judgment – The AFA Party would, by means provided for in the Judgment and the Peace Agreement, provide the water to a Judgment Party, and the Judgment Party would use the water to offset a replenishment obligation.
- Physical export of the water by an AFA Party or Judgment Party – The AFA Party or Judgment Party would produce the AFA Party's water through new or existing facilities and convey that water out of the Chino Basin through surface facilities for subsequent use on lands that do not overlie or are not tributary to the Chino Basin.
- Exchange export by a Judgment Party – The AFA Party would provide water to a Judgment Party, substituting that water for water that would otherwise be imported to the Basin; the avoided imported water would then be provided to some other non-Judgment entity at the direction of the AFA Party.
- Other unknown uses –Uses other than those listed above.

The potential for material physical injury from these proposed AFA related water uses is analyzed below. The basis for these findings is WEI's recent groundwater management alternative analyses, including the Peace II Agreement, investigations required by the December 2007 Court Order, and the proposed Dry-Year Yield Program expansion.

No significant changes in groundwater quality are expected from the first four uses listed above. Liquefaction potential and rising water will be unchanged with the first use, and liquefaction potential and rising water will be reduced with the second through fourth uses. No findings can be made regarding "other unknown uses." Groundwater level changes and the potential for subsidence will be addressed in this material physical injury analysis.

**Storage.** Currently, the water being sold under the AFA is in storage and is not causing material physical injury. Neither granting a new storage agreement to the AFA Party nor the maintenance of this water in storage will cause material physical injury to the Basin or a Party, provided that it is managed pursuant to the Judgment and the Peace Agreement.

**Use by a Judgment Party to Offset a Replenishment Obligation Pursuant to the Judgment.** Under this use, the AFA Party would, by means provided for in the Judgment and the Peace Agreement, provide some or all of the AFA Party's water to a Judgment Party, and the Judgment Party would use the water to offset a replenishment obligation. The net effect to the Basin will be a slight lowering of groundwater levels but only slightly more than would have occurred if the Overlying Non-Agricultural Pool Parties had produced their water. This lowering of groundwater levels will be less than 10 feet and will be in addition to the lowering of groundwater levels caused by re-operation. No material physical injury will occur to the Basin, provided that this lowering of groundwater levels does not contribute to subsidence in Management Zone 1 (MZ1).

As to the individual Parties, there will be no material physical injury, provided that this lowering of groundwater levels is addressed in the ongoing Recharge Master Plan Update, in future Recharge Master Plan updates, and in Watermaster's continuing assessment of the balance of recharge and discharge pursuant to the Peace Agreement, and provided that this lowering of groundwater levels does not contribute to subsidence in MZ1.

**Physical Export of the Water by an AFA Party or Judgment Party.** Under this use, an AFA Party or Judgment Party would produce the AFA Party's water through new or existing facilities, convey that water out of the Chino Basin through surface facilities for subsequent use on lands that do not overlie or are not tributary to the Chino Basin. To the Basin as a whole, the impacts would be identical to the previous water use alternative. The loss of return flows from the export of this water would be compensated by return flows from supplemental water.

As to individual Parties, there will be no material physical injury, provided that this lowering of groundwater levels is addressed in the ongoing Recharge Master Plan Update, in future Recharge Master Plan updates, and in Watermaster's continuing assessment of the balance recharge and discharge pursuant to the Peace Agreement, and provided that this lowering of groundwater levels does not contribute to subsidence in MZ1.

**Exchange Export by a Judgment Party.** Under this use, the AFA Party would provide water from its storage account to a Judgment Party, substituting that water for water that would otherwise be imported into the Basin; the avoided imported water would then be provided to some other non-Judgment entity at the direction of the AFA Party. To the Basin as a whole, the impacts would be identical to the physical export alternative.

As to individual Parties, there will be no material physical injury, provided that this lowering of groundwater levels is addressed in the ongoing Recharge Master Plan Update, in future Recharge Master Plan updates, and in Watermaster's continuing assessment of the balance recharge and discharge pursuant to the Peace Agreement, and provided that this lowering of groundwater levels does not contribute to subsidence in MZ1.

**Other Unknown Uses.** No material physical injury findings can be made regarding any other uses.

**Conclusion:** No material physical injury will result from the anticipated known uses of the stored water so long as the storage and recovery agreement is conditioned upon adherence to the Judgment, the Peace Agreement, and the requirement that the recovery does not cause permanent subsidence.

### **3. Storage and Recovery Agreement**

Included with this staff report is a draft template storage and recovery agreement. This agreement contains conditionality with regard to prevention of Material Physical Injury as described below. The agreement is based on the terms that have been under discussion by the members of the Appropriative Pool for several months.

This agreement will need Court approval. Assuming approval by the Watermaster Board at its June meeting, staff and legal counsel will be prepared to submit the agreement to the Court for approval in the July time-frame.

Throughout the process of development of the terms of the storage and recovery agreement, the issue of whether the stored water may be available for export has been highlighted and thus it is relevant to address it at length here.

Staff and legal counsel believe there is a reasonable basis to conclude that the stored water may be exported without the imposition of a replenishment assessment.

The Judgment does not prohibit exports. When allocating storage capacity, Watermaster must give priority to the overlying needs of the parties over exports. (Judgment Paragraph 12.) In fact, Watermaster has consistently adhered to the goal by facilitating local storage opportunities. Today more than 200,000 acre-feet of water is stored within the Basin for local, predominantly overlying use.

The only reference to the export of water derives from the Appropriative Pool Pooling Plan. (Judgment Exhibit H.) The Plan establishes a requirement that Watermaster replenish water that is exported from the Basin by Appropriators. However, it already exempts certain exports from the requirement. Thus, the condition is not absolute as it applies to the members of the Appropriative Pool.

In the instant case, the water stored by the Overlying (Non-Agricultural) Pool derives from overlying water rights. The Pooling Plan for the Overlying (Non-Agricultural) Pool does not contain an export limitation. That is, absent a court adjudication, overlying water rights are generally not transferable. They also cannot be stored.

The Judgment did provide members of the Pool with right to make assignments to appropriators. Later, the Peace Agreement and further Judgment amendment expanded the transferability of the Overlying (Non-Agricultural) Pool water rights, and the Peace II Agreement extended this right further still. Moreover, the Judgment has always allowed members of the Overlying (Non-Agricultural) Pool to store water as Carry-Over. (Exhibit G Paragraph 7). It also should be noted that the Judgment actually facilitates the prospect of Carry-Over and storage by expressly authorizing members of the Pool to receive imported water and to Carry-Over the unused quantity. Modernly, we generally refer to such activity as "in lieu" storage. (Exhibit G Paragraph 8).

Regardless, up until the Peace Agreement, the exportation of stored water originating from the Overlying (Non-Agricultural) Pool was simply not addressed. Generally, the replenishment condition on exports was linked to the quantity of water physically exported in 1976. Staff's view is that the Judgment simply sought to protect the Basin's safe yield and its historical forms of recharge. Indeed, the subject of recharge remains a key concern for Watermaster in the future, but the likelihood that the return flows from the applied water that could be beneficially used by the members of the Pool had the water not been stored, would be relatively miniscule.

On the basis of the above, staff recommends that the Pools recommend approval of the draft storage and recovery agreement as a template agreement for use with the successful auction bidder as conditioned with respect to avoidance of Material Physical Injury as described above and conditioned upon the use of auction proceeds as described above.

#### **Professional Consulting Services:**

Auctions have long been relied upon to create an open and transparent process to establish a fair market value price for an asset. Auction of real property assets have occurred within a fairly routine and generic process. However, in the case of the auction of the Overlying (Non-Agricultural) Pool water and the related storage and recovery agreement, the characterization of the asset and the procedure is more complex. While there have been auctions of water and water rights, Watermaster staff and counsel believe that Watermaster should retain professional support to assist in publicizing and conducting the auction. The assets are of extreme importance to the stakeholders and professional help is prudent. Watermaster has contacted public and private professionals to obtain their opinion as to qualified parties to conduct these services and it has obtained conceptual and specific proposals as to conducting the services and as for success fees. Watermaster will present a summary of its findings in closed session. Staff recommends that subject to reaching an agreement on terms, Watermaster should retain a qualified provider of auction and publicity services

**CHINO BASIN WATERMASTER**

**Case No. RCV 51010**

**Chino Basin Municipal Water District v. The City of Chino**

**PROOF OF SERVICE**

I declare that:

I am employed in the County of San Bernardino, California. I am over the age of 18 years and not a party to the within action. My business address is Chino Basin Watermaster, 9641 San Bernardino Road, Rancho Cucamonga, California 91730; telephone (909) 484-3888.

On July 20, 2009 I served the following:

- 1) **NOTICE OF MOTION FOR APPROVAL OF TEMPLATE STORAGE AND RECOVERY AGREEMENT**
- 2) **MOTION FOR APPROVAL OF TEMPLATE STORAGE AND RECOVERY AGREEMENT**

☒ BY MAIL: in said cause, by placing a true copy thereof enclosed with postage thereon fully prepaid, for delivery by United States Postal Service mail at Rancho Cucamonga, California, addresses as follows:  
**See attached service list: Mailing List 1**

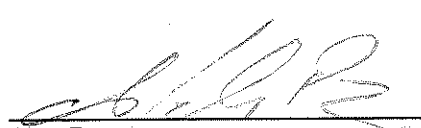
☐ BY PERSONAL SERVICE: I caused such envelope to be delivered by hand to the addressee.

☐ BY FACSIMILE: I transmitted said document by fax transmission from (909) 484-3890 to the fax number(s) indicated. The transmission was reported as complete on the transmission report, which was properly issued by the transmitting fax machine.

☒ BY ELECTRONIC MAIL: I transmitted notice of availability of electronic documents by electronic transmission to the email address indicated. The transmission was reported as complete on the transmission report, which was properly issued by the transmitting electronic mail device.

I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Executed on July 20, 2009 in Rancho Cucamonga, California.

  
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