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MEMORANDUM

TO: Board of Directors
Monterey Peninsula Water Management District

FROM: Ellison Folk; Amanda Garcia

DATE: August 11, 2010

RE: Legal Issues re: Joint Application of Security National Guaranty, Inc. and
California American Water for Amendment to Water Distribution System
(Application # 20080915MBS)

INTRODUCTION

This memorandum addresses legal issues raised by members of the Board of Directors at the July 19, 2010 public hearing regarding the joint application by Security National Guaranty, Inc. ("SNG") and California American Water ("Cal-Am") for an amendment to Cal-Am's water distribution system permit (the "WDS permit") to enable service to the proposed Monterey Bay Shores Ecoresort (the "Project"). The issues addressed below include legal issues raised in a letter submitted by the Sierra Club on July 17, 2010 and the trial court's recent order setting forth the parameters for District action at its August 16, 2010 hearing.

I. LEGAL FRAMEWORK GOVERNING THE BOARD'S ACTION.

A. The May 11, 2009 Trial Court Ruling and The Court of Appeal's April 1, 2010 Ruling.

After SNG brought a motion in the trial court challenging the District's March 2009 denial of the joint, the trial court held that no party to the Amended Decision could require environmental review under CEQA with regard to Seaside Basin usage. The trial court ordered the Water Management District to set aside its denial of the joint application, "and in particular Findings Numbered 17 through 21," which addressed the need for a subsequent environmental impact report to evaluate impacts related to both the Seaside Basin and the Carmel River. The trial court further ordered the Water Management District to reopen the hearing and reconsider the application in light of its

ruling. With respect to concerns about impacts on the Carmel River, the trial court held that commingling water from the Carmel River and the Seaside Basin in storage tanks does not implicate effects on the Carmel River as a matter of law.

The Water Management District appealed the trial court's order. In *California American Water v. City of Seaside* (2010) 183 Cal.App.4th 471, the Court of Appeal construed the trial court's order narrowly to prohibit the Water Management District and other parties only from requiring CEQA review of potential environmental impacts on the Seaside Basin. The Court of Appeal did not find that the trial court's order prohibited the District from complying with CEQA generally with respect to projects that involve the use of Carmel River water. The court held that the trial court properly enjoined the Water Management District from complying with CEQA with respect to potential impacts on the Seaside Basin, because the Findings conflicted with the Amended Decision by requiring CEQA review with respect to issues addressed in the Amended Decision, including (1) the potential near-term adverse impacts to the Seaside Basin (Finding 17); (2) alternative sources of Seaside Basin water (Finding 18); and (3) environmental harm caused by extracting water from the Seaside Basin (Findings 19, 20, 21).

Importantly, the court noted that Findings 19, 20, and 21 were based only in part upon impacts to the Seaside Basin. The court therefore clarified that the trial court's order "does not entirely invalidate [these findings] and [their] concomitant call for a subsequent EIR, but only disapproves [them] to the extent that [they] conflict with the physical solution—that is, to the extent that [they] 'reference a need for CEQA review of the impact of the application on Seaside Basin production.'" 183 Cal. App.4th at 481. In addition, the court found "the District, not the court, had jurisdiction to require CEQA review to the extent that potential impacts on Carmel River water usage existed" *Id.* at 482.

B. The Trial Court's August 2010 Order.

Since the Court of Appeal issued its decision, the District entered into a stipulation and order agreeing that it would reach a final decision on the Application by July 19, 2010. At the July 19 hearing, the Board requested additional analysis of issues raised by the Sierra Club and the Court of Appeal decision and continued the matter until August 16, 2010. SNG and Cal-Am brought an ex parte application asking the court to find four members of the District Board in contempt and to order approval of the Application. The application was denied. However, the Court issued an order requiring the District to do several things:

1. Set aside its denial of the Application and the findings in support of that denial by August 16, 2010;
2. Make a final decision on the Application by August 16, 2010 based on the evidence submitted prior to the close of the July 19, 2010 hearing;
3. Make a report to the court on the District's decision, including its findings, by August 23, 2010.

The court also indicated that in addressing potential use of Carmel River water the District was limited to requiring an accounting that ensures no Carmel River water is being used to serve the Project. The court also indicated that the commingling of water from the Carmel River with Seaside Basin water did not constitute an environmental impact.

II. The District's Role in Reviewing the Potential Environmental Impacts of the WDS Permit In Light of the Rulings of the Court of Appeal and the Trial Court.

The District's action on the WDS permit is a discretionary action that triggers the requirements of CEQA under Public Resources Code section 21166. Because the WDS Permit is an approval for a larger project that has already undergone CEQA review, it is not considered a new project. CEQA Guidelines §15378 (c) ("The term 'project' refers to the activity which is being approved and which may be subject to several discretionary approvals by governmental agencies. The term 'project' does not mean each separate governmental approval.")

As a responsible agency, the District may require supplemental environmental review of the Application if it determines that the Application will result in significant new environmental impacts that were not previously analyzed. Pub. Res. Code §21166; CEQA Guidelines §15162.

A. Scope of the District's Authority to Review Impacts.

Pursuant to the 2009 order of the trial court and the ruling of the Court of Appeal in *California American Water v. City of Seaside*, 183 Cal. App. 4th 471, 481-82 (2010), the District may only evaluate impacts that would result from the use of Carmel River water. In addition, based on a July 30, 2010 *ex parte* hearing before Judge Roger Randall, the August 2010 proposed order that the court has indicated it will sign provides that the District may only consider evidence before it as of the close of its July 19, 2010 meeting. The proposed order also indicates that the District is limited to requiring an

accounting of water to assure that no Carmel River water is being used serve the Project.

Under these orders, the Board retains the discretion to determine whether, based on the evidence before the District at the close of its July 19, 2010 hearing, the WDS permit will cause the use of water from the Carmel River and whether that use will result in significant environmental impacts. In exercising this discretion, the Board can evaluate the adequacy of the current front-loading agreement and determine whether it provides sufficient detail to ensure that the WDS permit will not divert Carmel River water to serve the Project. The District may remedy any ambiguities in the front-loading agreement, without requiring an SEIR, by imposing conditions on the WDS permit that are designed to ensure that no Carmel River water will be used to serve the Project. District staff have proposed conditions designed to make the front-loading agreement more specific and enforceable such that the District can account for water use related to the project.

Finally, the District may require preparation of a subsequent or supplement EIR, only if the Board finds that (1) the Application cannot be conditioned to avoid the increased diversions; and (2) any increased diversions from the Carmel River will result in new or more severe significant impacts on the environment. If the Board is to make this determination, it should make detailed findings to support this decision based on substantial evidence in the record as of the close of the hearing on July 19, 2010.

B. Arguments Raised By the Sierra Club in Its July 16, 2010 Letter and By Board Members at the July 19, 2010 Hearing.

The Sierra Club has raised a number of theories upon which it believes that the WDS permit will result in increased use of water from the Carmel River – regardless of whether the District imposes conditions that would ensure enough Seaside Basin water to pumped to serve this Project. Members of the District Board also expressed concern about the potential for the WDS Permit to increase pumping from the Carmel River. These are discussed below.

1. Whether Approval of the WDS Permit Will Create An Incentive to Pump Water from the Carmel River to Serve other Projects.

The Sierra Club is concerned that approval of the Project will create an incentive for Cal-Am to increase diversions from the Carmel River. According to the Sierra Club's theory, by supplying SNG with 90 acre-feet per year ("AFY"), Cal-Am will reduce the amount of Seaside Basin water available to it under the terms of the Amended Decision, which governs the allocation of groundwater rights in the Seaside Basin. The Sierra Club is concerned that Cal-Am will then attempt to make up for this reduction in

its Seaside Basin allocation by increasing its diversions from the Carmel River.

However, the Amended Decision provides rights to two categories of producers: Standard Producers and Alternative Producers. Amended Decision at 17-21. SNG is an Alternative Producer, and Cal-Am is a Standard Producer. *See id.* at 19, 21. SNG, as an Alternative Producer, generally has the right to an Alternative Production Allocation, which is a fixed amount of water each year. *See id.* at 20-21.¹ Cal-Am, as a Standard Producer, is assigned a percentage-based water right, for which it receives a pro rata amount of the remaining available water after subtracting the sum of the Alternative Production Allocations. *Id.* at 18-19; *see also id.* at 11 (definition of "Alternative Production Allocation").

Thus, under the Amended Decision, Cal-Am's right to Seaside Basin water is constrained by the fixed amount of SNG's right as an Alternative Producer, regardless of whether SNG actually produces any groundwater. For this reason, the Application will not reduce the amount of Seaside Basin water available to Cal-Am, and will not increase its incentive to divert water from the Carmel River.

The Sierra Club also argues that the provisions in the Amended Decision allowing Cal-Am to carry over any unused portion of Seaside Basin water to future years, combined with the replenishment fee charged for pumping from the Seaside Basin, create an incentive to pump from the Carmel River up to the limits set by the State Board's Cease and Desist Order. Sierra Club Letter at p. 6. The Sierra Club believes that approval of the WDS permit will exacerbate this situation by adding to the amount of water pumped from the Seaside Basin. Under the Sierra Club's theory, Cal-Am could then increase pumping from the Carmel River over existing baseline conditions to serve other users.

We do not believe that the trial court envisioned this as a basis for additional environmental review. Rather, the Amended Decision already assumes that SNG's right to 149 AFY will be supplied from the Seaside Basin, and anticipates that it could be supplied through inland wells. Thus, we believe that the court is likely to conclude that any incentive to increase diversions from the Carmel River is a result of that decision and not the Application itself. If the Board does not agree with this assessment, it would need to adopt findings specifically detailing how the Application

¹ An exception exists if the Watermaster or other competent governmental authority requires reductions in production beyond the level that can be obtained by reducing Standard Producers' allocations to zero. Amended Decision at 20-21.

itself would actually cause increased pumping from the Carmel River based on the record as of July 19, 2010.

2. Use of ASR Water.

Sierra Club is further concerned that the Application does not provide adequate assurance that Cal-Am will be prohibited from using water obtained through the Aquifer Storage and Recovery project ("ASR project") to serve the project. *See* Sierra Club letter at 9-10. In our view, however, Cal-Am has little incentive to serve the Project with ASR project water. State Water Resources Control Board (SWRCB) Order 09-60 provides that ASR project water must be used to mitigate the effects of Cal-Am's illegal diversions, and therefore requires Cal-Am to subtract the amount of ASR project water it uses to supply customers from the base level of its illegal Carmel River diversions. (*See* Order 09-60, at 57-60.) Under the Amended Decision Cal-Am can produce up to 149 AFY of Seaside Basin water for SNG without having to offset that production, because SNG has its own water right under that decision. Because Cal-Am must offset ASR project water with reductions in illegal diversions, it has little incentive to supply the Project with ASR project water rather than with water secured by SNG's right.

In addition, the interagency Quarterly Water Supply Strategy and Budget directs Cal-Am to first use its Seaside Basin water rights, then injected ASR water, before using water from the Carmel River.

A related question from a Board member is whether withdrawals from the River caused by the WDS Permit might interfere with the minimum bypass flows required for the ASR Project.² As discussed above, we do not believe that the WDS Permit itself will cause additional withdrawals from the River. Rather, any incentive to pump more from the River is a consequence of the Amended Decision. As discussed below, staff is proposing conditions designed to address water accounting by Cal-Am that should avoid additional pumping from the River to service the Project.

3. Use of Carmel River Water In Tanks Used by Cal-Am.

A question was also raised at the July 19 hearing as to whether the use of Carmel River water that was already stored in the Hilby tanks would constitute a use of Carmel River water triggering the requirements of CEQA. The trial court's May 11,

² Phase 1 ASR Project bypass flow requirements range from 40 cfs to 200 cfs, depending on the month and phase of the steelhead life cycle.

2009 order clearly considers such use of Carmel River water to be a mixing of molecules – as long as enough Seaside Basin water is pumped into the Cal-Am system to cover the use by the Project. The Court of Appeal affirmed this decision. Therefore, the fact that Carmel River water may be in tanks used to store water for service to the Project should not be used a basis for requiring further CEQA review.

4. Impacts of the WDS Permit on Cal-Am's Storage Capacity.

A number of questions were raised about whether Cal-Am has adequate storage and production capacity to serve the Project without pumping more water from the Carmel River. The water accounting performance standards identified by staff in Attachments 3 and 4 of the Conditions of Approval are designed to address these issues.

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