STATE OF IDAHO

OFFICE OF THE ATTORNEY GENERAL

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April 13, 2009

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Re: Proposed Settlement of SRBA Consolidated Subcase 00-92023

Dear Randy:

Thank you for your letter of April 9 regarding the "Framework Reaffirming the Swan Falls Settlement," executed by the State of Idaho and Idaho Power Company on March 25, 2009 ("2009 Framework"). While the State notes that the concerns articulated in your letter are largely the same ones the State has previously discussed with you and other counsel for the other parties to SRBA Consolidated Subcase 00-92023 ("Subcase 00-92023"), we appreciate you taking the time to set forth your concerns in detail. The State has carefully considered the important issues in your letter and responds below, beginning with a few preliminary comments.

Given the number and nature of the concerns raised in your letter and our attempt to adequately address those concerns, our response is somewhat lengthy. This is unavoidable. As you know, the State obtained a favorable summary judgment decision disposing of most of the issues in Subcase 00-92023 before your clients intervened to be heard on the two remaining questions -- recharge subordination and the "zero flow" at Milner. The State's success was due in large part to reliance on the express language of the 1984 Swan Falls Agreement and the well-documented ratification and implementation proceedings on the Agreement. We found that questions of the interpretation of the Swan Falls Agreement are best approached from the standpoint of what the Agreement actually says and was understood to mean when it was executed. Accordingly, our responses herein rely heavily on quotations from the Agreement and the record.

Related to this point, we note that many of your concerns are not based on the language of the Swan Falls Agreement but rather on its precursor document, the

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October 1, 1984 "Framework for Final Resolution of Snake River Water Rights Controversy" ("1984 Framework"). While we agree that the 1984 Framework is a significant document, we advise caution in relying on it for purposes of understanding the elements and intent of the Swan Falls Settlement. The 1984 Framework was not intended as a final or comprehensive statement of the settlement but rather only as a general outline, and in fact makes no mention whatsoever of certain key elements of the final settlement, such as the Milner "zero flow" and the trust arrangement. It is more appropriate to rely on the Swan Falls Agreement itself, which was intended to memorialize the final settlement. *See* Swan Falls Agreement ¶ 19 ("This Agreement sets forth all the covenants, promises, provisions, agreements, condition, and understandings between the parties and there are no covenants, promises, provisions, agreements, conditions, or understandings, either oral or written between them other than are herein set forth.").

We also note that a number of the concerns raised in your letter are beyond the scope of Subcase 00-92023, which your letter apparently assumes was intended to be a global adjudication of all issues of the interpretation and application of the Swan Falls Agreement. In fact, the Court expressly limited Subcase 00-92023 to interpreting the Agreement for purposes of defining and decreeing the hydropower water rights enumerated in the Agreement, and for addressing the claims alleged in Idaho Power's Complaint.[1] It is inappropriate and contrary to the Court's orders to take issue with the proposed settlement based on matters that are beyond the scope of the current litigation and the proposed settlement. Further, the only components of the proposed settlement that require the Court's approval are the proposed partial decrees and the proposed dismissal order, which would resolve the issues on which your clients intervened—recharge subordination and the Milner "zero flow"—in terms quite favorable to your clients.

Finally, the State strongly disagrees with your assertion that the 2009 Framework was executed "without input" from the other parties to Subcase 00-92023. Rather than take time now to document each contact with counsel for other parties in this matter, the State will simply note that a draft of the proposed settlement was provided to counsel on February 23, 2008, followed by various phone calls and emails with counsel prior to the execution of the 2009 Framework. This was done even though the 2009 Framework simply reflects an understanding between the State of Idaho and Idaho Power Company, which by its plain terms only proposed a settlement acceptable to the signatory parties if the terms and conditions set forth in Article II are implemented.

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[1] *See* Order Granting in Part, Denying in Part Motion to Dismiss; Consolidating Common Issues Into Consolidated Subcase; and Permitting Discovery Pending Objection Period in Basin 02; and Notice of Scheduling Conference at 16 (July 24, 2007).

The 2009 Framework negotiations followed the same model as the 1984 negotiations. As in 1984, while the proposed settlement language was directly negotiated by representatives of the State and Idaho Power alone, the State sought input on the draft language from similarly-aligned parties, whose drafting suggestions were incorporated into the settlement documents to the extent possible. Also as in 1984, the State and Idaho Power collaborated in drafting an explanatory statement for purposes of clarifying questions and issues raised by other parties.[2] It is inevitable that some concerns will remain no matter how far the State and Idaho Power go to address them. The simple fact is that it is essentially impossible to draft a compromise settlement in a matter such as this that will be entirely acceptable in all regards to all interested persons. Further, it is important to recognize the Swan Falls Agreement was a compromise. Like Idaho Power, the State is obligated to uphold all aspects of that compromise, even those that some found to be objectionable in 1984, or find objectionable today.

Turning now to the specific concerns of your letter, you state that the Legislature and the media "appear to have been given a false impression" that the settlement is complete. The State has not characterized the settlement to the Legislature or the media as complete or as a "done deal," but rather has made it clear that the proposed settlement is just that—a proposal that must be fully implemented to be effective. While we share your concern that the proposed settlement is sometimes inaccurately characterized as being a final resolution, the fact is that the execution of the 2009 Framework did not, and was not intended to, effect a final settlement. Further, your suggestion that the settlement be finalized prior to passage of Senate Bill 1169 is contrary to the whole structure of the proposed settlement, which expressly requires that Senate Bill 1169 be passed as a pre-condition for the settlement to become effective. It is also contrary to the original Swan Falls Agreement, which required the passage of substantially similar legislation as a pre-condition for the Agreement to become effective. Senate Bill 1169 simply clarifies that the protections from ratepayer actions Idaho Power received as part of the original Swan Falls Settlement also extend to the 2009 reaffirmation of that Settlement. As such, objections to Senate Bill 1169 are essentially objections to the structure of the original Swan Falls Settlement, and holding up passage of Senate Bill 1169 would simply terminate the proposed settlement and return the parties to litigation.

Your letter also asserts that the proposed settlement creates a significant risk that the Swan Falls Settlement will be the subject of litigation again in the future, and that your clients have no interest in settling Subcase 00-92023 unless the matters being settled will no longer be disputed. This concern is ill-founded because, as previously discussed, Subcase 00-92023 is not and was never intended to be a global resolution of all issues of

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[2] The success and general acceptance that the Swan Falls Agreement has enjoyed in the past 25 years sometimes obscures the fact that, as the original ratification and implementation record demonstrates, a number of concerns with and objections to the Agreement were raised after it was executed but before it was fully implemented.

the interpretation and application of the Swan Falls Agreement: it simply defines and decrees the hydropower water rights enumerated in the Swan Falls Agreement. Issues such as water marketing and the overall management of the Snake River to meet minimum flows, while informed by the Swan Falls Agreement, were never a part of Subcase 00-92023 and were not part of the basis for your clients' intervention. These matters would remain susceptible to litigation regardless of the outcome of Subcase 00-92023.

Moreover, the SRBA Court has already dismissed without prejudice several "water availability" and water rights administration claims and an injunctive relief claim alleged in Idaho Power's Complaint.[3] Thus, the Court's own disposition of the issues has left open the risk of future litigation on certain aspects of the Swan Falls Agreement. While we understand your clients' desire to immediately resolve all issues hinging on the interpretation and/or application of the Swan Falls Agreement, some of these issues are simply beyond the scope of the instant litigation and the proposed settlement. This illustrates one of the purposes of Article III of the 2009 Framework: to avoid further litigation on these issues, if possible, through negotiation and settlement.

We now turn to and address the specific substantive concerns enumerated in your letter of April 9.

1. Water Marketing.

Your letter objects to the water marketing provision in Article III of the 2009 Framework on grounds that it "enhances" Idaho Power's ability to acquire water above Milner Dam for hydropower purposes, or "create[s] an entitlement in Idaho Power to acquire water above Milner for hydropower use below Milner." You further assert that the water marketing provision "misrepresents" the 1984 settlement, and further that the 1984 settlement contemplated a water marketing system only for "the express purpose of enabling domestic, commercial, municipal and industrial users to avoid costs associated with condemnation proceedings." This objection misreads both the 2009 Framework and the 1984 Swan Falls Settlement.

The water marketing provision of Article III of the 2009 Framework does not create or enhance any substantive rights or obligations regarding water marketing or water acquisitions. The plain language of Article III simply sets forth a non-exhaustive list of items for future discussion:

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[3] *See* Order Dismissing Claims Pertaining to Water Availability Without Prejudice and Denying Motion to Dismiss Claim for Injunctive Relief (Aug. 4, 2008).

> The parties recognize that the relationship established by the Swan Falls Settlement is important to the State of Idaho and Idaho Power Company, and that it is in their mutual long-term interest to cooperate regarding management of the water resources of the Snake River basin. In furtherance of that mutual interest the parties will endeavor, with good faith and comity, to cooperatively explore the resolution of issues associated with the subjects described below, and other issues that may arise, to the parties' mutual satisfaction, while also expressly recognizing and agreeing that nothing in this Framework limits or conditions the parties' rights to seek executive, administrative or judicial resolution of any such issues: . . . 5. Establishment of an effective water marketing system consistent with state law and existing water rights to accommodate the purchase, lease or conveyance of water for use at Idaho Power's hydroelectric facilities, including below Milner Dam, in addition to the average daily flows at the Murphy Gaging Station, while also optimizing the use of the water of the Snake River basin;

2009 Framework at 5-6. This plain language simply commits the parties to good faith discussions on certain issues—including but not limited to the establishment of a water marketing system consistent with state law, existing water rights and the optimum use of the waters of the Snake River basin—while reserving the right to litigate such issues, if ultimately necessary.[4] Nothing in this provision creates or enhances a right in Idaho Power to acquire water above Milner Dam. The State and Idaho Power further clarified this point in response to your concerns on it, and to remove any possible ambiguity, through their joint "Summary of Swan Falls Reaffirmation Settlement" ("Summary"), which is attached hereto:

> Article III identifies certain issues that will be the subject of future discussions between the State, Idaho Power and other affected interests. The parties intend such discussions to be inclusive rather than exclusive. Moreover, nothing in Article III is intended to define the rights or obligations of any person, reinterpret the Swan Falls Settlement, or prejudice any party affected by such issues. For example, the reference to discussions regarding the establishment of an effective [water] marketing system does not require any action by, or impose any obligations on, any person or entity. It is a commitment to have a good faith discussion of the issues associated with the water marketing issue and does not presuppose

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[4] The water marketing provision's reference to water purchases, leases or conveyances by Idaho Power acknowledges Paragraph 7.E. of the Swan Falls Agreement, which provides: "Company's ability to purchase, lease, own, or otherwise acquire water from sources upstream of its power plants and convey it to and past its power plants below Milner Dam shall not be limited by this agreement. Such flows shall be considered fluctuations resulting from operation of Company facilities."

> any particular outcome from such discussions. Likewise, the discussions regarding an acceptable program to monitor and measure flows at the Murphy Gage and procedures for re-evaluating term permits approved under Idaho Code § 42-203C do not contemplate any changes to the Swan Falls Settlement. Rather, these two issues, like the others identified in Article III, are illustrative of issues that warrant further discussion to determine whether an accord can be reached. Again, they do not presuppose any particular outcome from such discussions.

Summary at 2. In light of the plain language of the 2009 Framework and the Summary, we submit that your concerns regarding the water marketing provision of Article III of the 2009 Framework are unfounded. It is simply incorrect and inappropriate to interpret the water marketing provision as "creating" or "enhancing" any substantive water acquisition rights in Idaho Power.

It is also incorrect to characterize the water marketing provision as "misrepresenting" the Swan Falls Settlement. The 2009 Framework expressly provides that it should be interpreted to only reaffirm the Swan Falls Settlement, not to conflict with it:

> The parties through this Framework and its Exhibits reaffirm all aspects of the Swan Falls Settlement. This Framework and its Exhibits are consistent with the Swan Falls Settlement and clarify the original intent of the Swan Falls Settlement. Nothing in this Framework or its Exhibits changes, modifies, amends or alters any aspect of the Swan Falls Settlement.

2009 Framework at 7. We believe this language clearly and unambiguously disposes of any question as to whether the 2009 Framework modifies any aspect of the Swan Falls Settlement. Nonetheless, counsel for the other parties to Subcase 00-92023 voiced concerns on this and other points during our March 26 conference call. Thus, the State and Idaho Power further clarified in the Summary of Swan Falls Reaffirmation Settlement that the above-quoted provision means "the parties intend that the 2009 Framework and its Exhibits will be interpreted in harmony with the 1984 Swan Falls Settlement." Summary at 1. It follows that the water marketing provision of Article III was intended to be consistent with the Swan Falls Settlement and must be interpreted in harmony with it.

We must also point out that your letter was incorrect in asserting that the Swan Falls Settlement limited the establishment of a water marketing system to "the express purpose of enabling domestic, commercial, municipal, and industrial users to avoid the costs associated with condemnation proceedings." Paragraph 6 of the Swan Falls

Agreement is the only provision therein that addresses water marketing and simply provides, in relevant part, as follows:

> 6. Legislative Program
>
> The parties agree to propose and support the following legislation to implement this Agreement: . . . c. Establishment of an effective water marketing system.

Swan Falls Agreement ¶ 6.[5] There are no other references to water marketing in the Swan Falls Agreement. Thus, the Swan Falls Agreement does not contain any express or implied condition restricting water marketing to DCMI uses or condemnation proceedings. Indeed, your view that water marketing is limited to DCMI uses does not rely on the Swan Falls Agreement but rather on its precursor document, the 1984 Framework, the relevant portion of which provides as follows:

> 4. THE STATE SHOULD ENCOURAGE THE ESTABLISHMENT OF AN EFFECTIVE WATER MARKETING SYSTEM. . . . The day is also approaching when there will be no further water available for traditional appropriations. Therefore some provision must be made to enable people to acquire water rights outside of the appropriation process, over and above the amount reserved for DCMI. Private condemnation proceedings generally involve transaction costs which make it an unattractive alternative. The State should make it easier to get willing sellers together with willing buyers, and to facilitate approval of changes in the place of use.

1984 Framework at 6-7. Nothing in this provision expressly limits water marketing to DCMI uses. To the contrary, the provision refers without limitation to "an effective water marketing system," "traditional appropriations," "willing sellers" and "willing buyers." The references to DCMI uses and condemnation do not purport to limit water marketing to DCMI but rather simply point out that water marketing is preferable even in the DCMI context, because water marketing has lower transaction costs than condemnation proceedings. This interpretation finds support in the Swan Falls Agreement: had the parties intended to impose such an important DCMI limitation on

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[5] The Swan Falls Agreement included attached exhibits setting forth proposed legislation for each of the legislative initiatives listed in Paragraph 6, with the exception of the water marketing provision. The Agreement did not propose any specific water marketing legislation.

water marketing, they would have said so in the applicable provision of the operative and controlling document, or in proposed water marketing legislation, but they did not.[6]

Moreover, the plain language of the Swan Falls Agreement imposes no limitation on Idaho Power's ability to acquire water upstream from its power plants: "Company's ability to purchase, lease, own, or otherwise acquire water from sources upstream of its power plants and convey it to and past its power plants below Milner Dam shall not be limited by this agreement." Swan Falls Agreement ¶ 7.E. Thus, whatever ability Idaho Power had to acquire water above Milner prior to the Swan Falls Agreement, it retained after the Agreement was executed.

Prior to the Agreement, Idaho Power clearly had the ability to acquire storage water above Milner and convey it downstream for hydropower uses below Milner, in accordance with state law. The State has in its possession documentation showing that Idaho Power did so in 1981 and 1982—presumably Idaho Power does as well.

The ratification and implementation record for the Swan Falls Settlement further demonstrates that Idaho Power was acquiring water above Milner for hydropower use below Milner prior to the Settlement, and that the Settlement was not intended to change that state of affairs. For instance, Pat Costello, who negotiated the Swan Falls Agreement on behalf of Governor Evans, informed Senator Noh in one of the Senate Resources and Environment Committee hearings that under the Settlement, Idaho Power was "pretty well home free" on water purchases and could "acquire through purchase upstream stored water which they can run down the river":

> CHAIRMAN NOH: I have a question for any of you that would like to shoot at it. Under this agreement, what is to preclude a utility from if they can generate sufficient resources to buy up or lease whatever water they can get their hands on and in effect take up all of the remaining waters? As I read this, they're pretty well home free on all purchases -- purchased water and leased water.
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> MR. COSTELLO: Mr. Chairman, that's correct. They can acquire through purchase upstream stored water which they can run down the river. They are entitled to that and they can't of course be appropriated between the storage site and their hydro site. So they would be free to do that.

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[6] Given that the Swan Falls Agreement included several pieces of proposed legislation that were intended to be enacted to carry out the intent of the Settlement, the Settlement would also have included proposed legislation limiting water marketing to DCMI uses if that had been the parties' intent. No such legislation was proposed in the Agreement or during the ratification and implementation proceedings.

Transcript of Senate Resources and Environment Committee Hearing of Jan. 18, 1985 at 37.[7]

This facet of the Agreement was retained even though it met with objections from parties concerned with its impact, because it did not give Idaho Power anything new but simply recognized what the Company already had under existing state law, as demonstrated by the following excerpt from an Idaho Water Resource Board hearing on the 1984 Settlement:

> MR. HIATT: The company's ability to purchase (inaudible) all or otherwise acquire water pumps, and convey it to and past its power plants below Milner Dam shall not be limited by this agreement. Such flow shall be considered fluctuations resulting from the operation of the company's facilities.
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> MR. GRAY [IWRB Chairman]: What's the question, Mr. Hiatt?
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> MR. HIATT: The question I have is you give this kind of approval to Idaho Power and what's the limitations? This is the thing I'm -- this is just one of the things that I'm concerned about in this agreement. There are several others, but this is one I'm very concerned about.
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> MR. SHERMAN [IWRB Representative]: My first response to this particular objection is that it's not giving Idaho Power anything because they already have that right. Idaho Power can purchase water any place in the system they want and move it where they wish to. Concern to where it could lead to is not so much Idaho Power but economics. Conceivably, if Idaho Power could offer a farmer enough money for his water right, they'd buy his water right. Is Idaho Power to blame for that? Or is the farmer who sells his water right away to blame for that? That's a social question.

Transcript of Idaho Water Resource Board Hearing on Proposed Amendments to Policy 32 of the State Water Plan on Jan. 31, 1985 at 52-53.[8] Idaho Power's negotiator, Tom Nelson, also explained to Senator Crapo that the Company's ability to acquire upstream water was governed by existing state law and that the Agreement did not change this arrangement:

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[7] A copy of this transcript is attached as Exhibit 37 to the Affidavit of Michael C. Orr in Support of State of Idaho's Motion for Partial Summary Judgment, filed in Subcase 00-92023 on Jan. 9, 2008 ("First Orr Aff.").

[8] A copy of this transcript is attached as Exhibit 26 to the Third Affidavit of Michael C. Orr, filed in Subcase 00-92023 on July 18, 2008 ("Third Orr Aff.").

> SENATOR CRAPO: How would Idaho Power purchase water at the present time if they desired to do so? What would be the procedure it has to go through?
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> MR. NELSON: Mr. Chairman, Senator Crapo, if it's a one-year lease through the water supply bank, then that is handled -- I think that's been a lateral from the Department of Water Resources to the Committee of Nine. The company leases water on a one year basis. If it wants a longer term of use than a year under the water supply bank, then it needs to apply for a change in place of use, point of diversion, and nature of use with the Department of Water Resources. To the extent that that application involves more than 50 cfs or I think it's 5,000 acre feet, then it requires legislative approval. That is the existing law, and of course, this agreement and any of the legislation doesn't attempt to change that.

Transcript of Senate Resources and Environment Committee Hearing of Jan. 18, 1985 at 17-18.[9]

Thus, the plain language of the Swan Falls Agreement and the 1984 Framework, as well as the well-documented ratification and implementation record for the Settlement, conclusively demonstrate that the Swan Falls Settlement did not impose any restrictions on Idaho Power's ability to acquire water above Milner for hydropower uses below Milner. Rather than addressing this issue through private contractual provisions, the Settlement left it to state law. This approach is a key aspect of a guiding principle of the Swan Falls Agreement: that to as great an extent as possible, important issues should be controlled by state law rather than private contractual provisions. This approach provided greater security and transparency for all parties and better protected the public interest.

In sum, the 1984 Settlement did not create or enhance any right or entitlement in Idaho Power to acquire water above Milner. Rather, the Swan Falls Agreement recognized that under and subject to controlling state law (including the water supply bank rules and Committee of Nine determinations), Idaho Power already had the ability to acquire water above Milner for hydropower use below Milner, and the Settlement left that issue to state law. The 2009 Framework does nothing more than reaffirm this arrangement. Consistent with the original Settlement, the 2009 Framework expressly contemplates that Idaho Power's water acquisitions above Milner under any water marketing system shall be "consistent with state law and existing water rights . . . while also optimizing the use of the waters of the Snake River basin." 2009 Framework at 6. Any objection to the 2009 Framework on this point is in reality an objection to the

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[9] A copy of this transcript is attached as Exhibit 40 to the First Orr Aff.

original Swan Falls Agreement and state law. Moreover, the 2009 Framework necessarily recognizes that any change to the current marketing system must be resolved through administrative and legislative action, not through judicial action.

2. Management of Snake River Watershed To Meet Minimum Flows.

Your letter's objection to the 2009 Framework on this point also relies in large part on the incorrect assertion that the 2009 Framework or the proposed partial decrees "enhance" Idaho Power's ability to acquire water above Milner for hydropower uses below Milner, or "create" such an entitlement. These concerns are unfounded for the same reasons discussed above with respect to your water marketing objection.

Further, the provisions of the proposed partial decrees that are controlling with respect to the geographic and hydrologic scope of Idaho Power's legal entitlement expressly provide in unmistakable terms that the partial decrees carry no legal entitlement to acquire or obtain water above Milner:

> For the purposes of the determination and administration of this water right, no portion of the waters of the Snake River or surface or ground water tributary to the Snake River upstream from Milner Dam shall be considered. This water right may not be administered or enforced against any diversions or uses of the waters identified in this paragraph.

This language could not be clearer: the partial decrees have absolutely no legal effect or meaning upstream from Milner Dam. The partial decrees expressly state that they provide no legal basis for demanding or requesting the release of water past Milner Dam, and provide no legal basis for attempting to curtail or interfere with uses above Milner Dam.

Rather than discussing or even acknowledging this controlling language, your objection focuses on an entirely different provision of the partial decrees that is concerned with the quantity and measurement methodology for the Murphy minimum flows, and does not purport to define the legal or geographic scope of the water rights in question. The provision in question recites the Swan Falls Agreement's provision for "average daily flows" of 3,900 cfs and 5,600 cfs as measured at the Murphy Gaging Station, and then goes on to explain the measurement of these "average daily flows" using the language of Paragraph 7 of the Agreement, with one addition:

> Average daily flow, as used herein, shall be based upon actual flow conditions; thus, any fluctuations resulting from the operation of Idaho Power Company facilities shall not be considered in the calculation of such flows. Flows of water purchased, leased, owned or otherwise

> acquired by Idaho Power Company from sources upstream of its power plants, including above Milner Dam, and conveyed to and past its plants below Milner Dam shall be considered fluctuations resulting from the operation of Idaho Power Company facilities.

2009 Framework at Exhibit 6 (proposed partial decrees) (emphasis added). Thus, your assertion that the underlined phrase creates some new entitlement in Idaho Power to acquire water from above Milner Dam is wrong because the phrase occurs in a provision that does not define the legal, geographic or hydrologic scope of the water rights, but only addresses the Swan Falls Agreement's methodology for measuring "average daily flows" at the Murphy Gaging Station. Further, the underlined phrase only recognizes Idaho Power's ability under other state law to acquire water above Milner, which the Agreement left intact. Finally, the plain terms of the partial decrees make it clear they carry no entitlement to any waters above Milner Dam. Thus, your assertion that the partial decrees "create" or "enhance" an entitlement to acquire water above Milner is groundless.

Your further contention that the 2009 Framework should resolve all questions regarding the overall administration of the Snake River to meet the minimum flows of the Swan Falls Settlement fails to recognize the scope of the issues that may be addressed and resolved in Subcase 00-92023. As previously discussed, the Court's consolidation order defined Subcase 00-92023 not as a global resolution of all issues of interpretation of the Swan Falls Agreement, but only as a proceeding to define and decree the hydropower water rights that are subject to the Agreement. Further, in denying Idaho Power's motion to consolidate all of the Milner "zero flow" issues raised in Subcases 02-0200 and 92-0002GP with Subcase 00-92023, the Court signaled that it would be inappropriate to combine the narrow question of the effect of the Agreement's "zero flow" provision on the hydropower water rights with the broader question of the global effect of the Milner "zero flow" policy in the overall management of the Snake River. Your proposal to resolve the latter with the former goes beyond the scope of Subcase 00-92023 and would violate the Court's orders by seeking to resolve broad issues of the overall management of the Snake River in Subcase 00-92023. The appropriate proceedings for those issues are not Subcase 00-92023 but rather Subcases 02-0200 and 92-0002GP.

Your objection regarding minimum flows administration also makes the incorrect and problematic blanket assertion that under the Swan Falls Settlement, the use of water in excess of the minimum flows "is inferior to the use of water for depletionary purposes." This statement evidences a fundamental misapprehension of key aspects of the Settlement and simultaneously overstates and understates the degree to which hydropower is subordinate to other uses under the Settlement.

The Settlement establishes two different types of water rights and subordination regimes, and under neither is hydropower use of flows above the minimum flows "inherently inferior" to other uses below Milner Dam. Rather, the minimum flow water rights held by the Company are subordinate ("inferior") only to those uses specifically defined in Paragraphs 7.C. and 7.D. of the Agreement. Further, hydropower uses under the water rights held in trust by the State are "subordinatable" to other depletionary uses, but only for those uses that satisfy the "public interest" criteria in Idaho Code § 42-203C. Thus, characterizing the Settlement as making hydropower use "inherently inferior" to other uses overstates subordination with respect to other uses below Milner Dam.

On the other hand, characterizing hydropower use below Milner as "inherently inferior" to other uses above Milner understates the effect of the Settlement. The "inherently inferior" language incorrectly implies that the hydropower water rights below Milner Dam have legal standing to make a call above Milner, but that this entitlement has been subordinated. This is incorrect because neither the hydropower water rights held by Idaho Power nor the hydropower water rights held in trust by the State have any legal standing, meaning, entitlement or effect whatsoever upstream from Milner Dam.

Your proposed solutions to your concerns regarding the issue of administration of the Snake River to meet the minimum flows are therefore inappropriate and/or unnecessary. In particular, given that the Court has segregated the issues of the effect of the Milner "zero flow" on the hydropower water rights in question in Subcase 00-92023 from the broader question of the effect of the "zero flow" on the overall administration and management of the Snake River, the State could not agree to forego participation in SRBA Subcases Nos. 92-0002GP and 02-0200.

Further, your suggestion that the partial decrees should contain a provision limiting Idaho Power Company's ability to acquire water above Milner fails to recognize that the partial decrees pertain only to waters appropriated for hydropower purposes below Milner, while Idaho Power's ability to otherwise acquire water above Milner is governed by State law. It is inappropriate to attempt to use the partial decrees to resolve matters that are outside the scope of the water rights being decreed.

3. Lack of Preference for Agricultural Water Use.

Your letter next objects that rather than giving agricultural uses priority, the 2009 Framework implies that all water uses will be treated equally. Your letter does not specifically explain the basis of this objection, but our prior discussions with you on this concern indicate that it is based on section 2 of the 1984 Framework, which among other things provides that in allocating the remaining water resources of the Snake River, "[p]riority should be given to projects which promote Idaho's family farming tradition and which will create jobs." 1984 Framework at 4. Your objection, as we understand it,

is that this particular provision of the 1984 Framework was not recited in the 2009 Framework.

As we have explained to you previously and as discussed above, the State and Idaho Power did not attempt in the 2009 Framework to recite each and every passage from all of the original Swan Falls Settlement documents. Rather, the 2009 Framework globally reaffirms all aspects of the Swan Falls Settlement and specifically recites only those provisions that were deemed appropriate to provide context for purposes of clarifying the issues being resolved in defining and decreeing the water rights: ownership, recharge subordination and the Milner Divide. We explained to you and other counsel that this approach was not intended to diminish agricultural uses or to in any way alter the focus, purpose or intent of the original Settlement. Nonetheless, to address your concern, the State and Idaho Power specifically stated in the "Summary" as follows:

> The fact that the 2009 Framework does not recite all of the provisions of the 1984 Swan Falls Settlement does not diminish the continuing importance or effect of other provisions of the 1984 Settlement. Rather, the 2009 Framework expressly reaffirms all aspects of the 1984 Swan Falls Settlement and does not alter or revise in any way the statutory provisions adopted as part of that Settlement, including but not limited to those provisions applicable to agriculture and the family farming tradition in Idaho.

Summary at 2. Further, your proposed solution to your objection regarding the priority of agricultural uses hinges on the 1984 Framework rather than the Swan Falls Agreement. As previously discussed, the Agreement is the controlling document and is a more comprehensive and detailed statement of the Settlement than the 1984 Framework. The Swan Falls Agreement did not address the priority of agricultural uses in the contractual provisions of the Agreement, but rather made it an issue of state law, by making "promotion of the family farming tradition" one of the public interest criteria in Idaho Code § 42-203C. This provision was enacted and remains law, and it is this statutory provision, not the contractual provisions of the 1984 Framework or the 1984 Swan Falls Agreement, that governs allocation of water made available through subordination of the water rights held in trust by the State. This approach was in fact a critical aspect of the Agreement: the parties chose to make the establishment of the trust, and the subordination of the water rights held in trust by the State, matters controlled by state law rather than by contractual provisions.

Your proposed solution would change this approach by suggesting that agricultural priority is controlled by private contractual provisions rather than state law. A key achievement of the 1984 Swan Falls Settlement was insuring that the State retained control over the allocation and management of the water resources of the Snake River

through state law and the state water plan. It would be unwise to suggest that this approach is being abandoned or replaced by private contractual provisions, but that is what your proposed solution would do.

4. Accounting for Minimum Flows at the Murphy Gaging Station.

Your concern regarding the accounting for the minimum flows asserts that neither the 1984 Swan Falls Settlement nor the 2009 Framework clearly states the effect of United States Bureau of Reclamation flows, unused flows spilling past Milner, or other water acquired by Idaho Power upon the accounting of the minimum flows of 3,900 cfs and 5,600 cfs as measured at the Murphy Gaging Station.

This objection is incorrect as to the accounting of water acquired by Idaho Power, which is specifically addressed in the Swan Falls Agreement and the 2009 Framework. As previously pointed out, the Swan Falls Agreement expressly provides that "any fluctuations resulting from the operation of Company facilities shall not be considered in the calculation of the minimum daily stream flows set forth herein," and further provides that upstream flows acquired by Idaho Power Company "shall be considered fluctuations resulting from the operation of Company facilities." Swan Falls Agreement ¶¶ 7.B., 7.E. Accordingly, the express language of the Swan Falls Agreement requires that flows resulting from water acquired by Idaho Power are not to be counted in making determinations of whether the minimum flows are present at the Murphy Gaging Station.[10]

Idaho Water Resource Board representative Frank Sherman made the same point in the Board's January 31, 1985 hearing on the State Water Plan amendments proposed for purposes of implementing the Swan Falls Settlement:

> UNIDENTIFIED SPEAKER: (Inaudible) on this minimum-maximum flow, what they buy up there, will that be included in it? That is over and above if they buy other water?
>
> MR. SHERMAN: Yes. If they buy water and move it down, that will not count toward the flow going past the gauge. But it's a two-sided coin. If we shut off the gauge at CJ Strike, for example, the natural flow that should have been going through there is added to the flow going past the Milner gauge so it balances out in terms of (inaudible).

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[10] By the same token, the Swan Falls Agreement also precludes consideration of shortfalls that result from the operation of Idaho Power's power plants, such as releases and load following operations at C.J. Strike.

Transcript of Idaho Water Resource Board Hearing on Proposed Amendments to Policy 32 of the State Water Plan on Jan. 31, 1985 at 54.[11] The 2009 Framework reaffirms this element of the Swan Falls Settlement by including the relevant "fluctuations" language of Paragraph 7 of the Swan Falls Agreement in the partial decree remarks that address the minimum flows at the Murphy Gaging Station.

On the other hand, you are correct in asserting that the 2009 Framework and the Swan Falls Settlement do not specifically address the effect of United States Bureau of Reclamation flows and unused water spilling past Milner in accounting for the minimum flows as measured at the Murphy Gaging Station. This is as it should be, because the accounting for Bureau water and other leased water is governed by the applicable lease agreements and state law, not the Swan Falls Settlement. Further, while we agree these are important issues, they are best addressed in a concrete factual setting rather than a hypothetical one, and in the context of a proposed measurement methodology that takes all relevant factors into account, not just those you identified in your letter.

Other than including in the partial decrees the Swan Falls Agreement's provisions regarding Murphy flow measurement and accounting (which has been done), the Murphy measurement and accounting matters referenced in your letter must be addressed in another forum with all affected interests. Article III of the 2009 Framework simply acknowledges that cooperative discussions should be considered before resorting to litigation. Article III, however, expressly reserves the right to seek judicial relief if it is ultimately necessary. We expect that discussions would include your clients, as the State and Idaho Power acknowledged in the Summary: "Article III identifies certain issues that will be the subject of future discussions between the State, Idaho Power and other affected interests. The parties intend such discussions to be inclusive rather than exclusive." Summary at 2.

5. Effect of the Trust Water Line.

Your objection to the 2009 Framework regarding the "trust water line" proposes to add a condition to the partial decrees stating that no water right located outside the trust water area will be subject to curtailment in order to satisfy Idaho Power's water right at Swan Falls regardless of whether the ESPA ground water model shows such water rights to be tributary to the Snake River below Milner. This objection fails to acknowledge that the "trust water line" is a creation of IDWR's administrative rules regarding water appropriation, that it was not established by the Swan Falls Agreement, and that Idaho Code § 42-203B(2) and the corresponding Milner provisions of the partial decrees expressly resolve your concern.

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[11] A copy of this transcript is attached as Exhibit 26 to the Third Orr Aff.

The parties to the Swan Falls Agreement addressed the issues associated with what ultimately became the "trust water line" by agreeing that Idaho Code § 42-203B(2) should be amended to provide that waters upstream from Milner Dam may not be considered for purposes of the definition or administration of water rights downstream from Milner Dam. *See* Idaho Code § 42-203B(2) (1986 amendment). As previously discussed, this language has been included in the proposed partial decrees. Thus, the water rights are already wholly limited, both by statute and by Idaho Power's contractual consent, to the Snake River downstream from Milner Dam and the ground and surface water tributary to that reach of the Snake River. We also reiterate that the 2009 Framework does not contemplate any changes in the "trust water line."

6. State Support of Idaho Power Before The Idaho Public Utilities Commission.

This objection asserts that the Memorandum of Agreement proposed by the 2009 Framework should be amended to provide that the State "will not object," rather than "will support" Idaho Power in regulatory proceedings before the Idaho Public Utilities Commission regarding rate impacts directly attributable to the implementation of managed recharge.

We have previously discussed this objection with you at length and explained that the Memorandum of Agreement simply does not have the effect of requiring the State to blindly support each and every rate proposal that Idaho Power puts before the IPUC, as you seem to believe. The language and intent of the Memorandum of Agreement is much more limited: "Paragraph 5 of the Memorandum [of Agreement] does not require the Governor or the Board to take any affirmative position on whether a specific request by the Company is appropriate or necessary or on how any resulting rate impact should be allocated." Summary at 4. Paragraph 5 simply recognizes that the State should acknowledge that managed recharge can have direct effects on hydropower generation but preserves the discretion of the Governor and the Board to independently determine the "direct impacts" that may arise from the implementation of managed recharge. Summary at 4.

In addition, and contrary to your objection, there is nothing unusual or inappropriate about the State appearing and/or taking a position before a state agency, and in fact this happens quite frequently. Moreover, your objection appears to incorrectly assume that the Swan Falls Agreement categorically bars Idaho Power from seeking rate increases if the Milner and Murphy minimum flows are satisfied. Nothing in the Swan Falls Settlement limits or expands Idaho Power's ability to seek rate increases. This right arises under state law and for this reason should not be addressed by contractual provisions in the Memorandum of Agreement. For this same reason, we also disagree with your suggestion to have the Memorandum of Agreement amended to address whether the IPUC is required to increase rates as a result of the direct impacts of

managed recharge. Rate increases should be controlled by state law, not private contracts, and this is how the Memorandum of Agreement is currently structured. Your suggestions would unwisely suggest a change in that approach.

7. Discussion of Additional Issues.

Your objection on this point is that Article III of the 2009 Framework should be amended to state that all parties to Subcase 00-92023 will be given notice and a meaningful opportunity to participate in the discussions contemplated under Article III. We respectfully suggest that your proposal is too narrow and reflects a misunderstanding of the scope of Subcase 00-92023 and Article III. As previously discussed, under the Court's orders, the Subcase 00-92023 is intended simply to define and decree the water rights, and to address Idaho Power's Complaint, and the only substantive issues remaining in the litigation are the questions of recharge subordination and the Milner "zero flow." These issues would be resolved through the partial decrees and the dismissal order proposed under the 2009 Framework.

The matters contemplated in Article III are beyond the scope of Subcase 00-92023 and therefore discussions should not be limited to the parties to that Subcase, as you have proposed. Rather, such discussions should be open to all affected interests, and the State and Idaho Power have already clarified that this is the intent of Article III: "Article III identifies certain issues that will be the subject of future discussions between the State, Idaho Power and other affected interests. The parties intend such discussions to be inclusive rather than exclusive." Summary at 2.

Once again, we appreciate your letter and your comments. We hope that this admittedly lengthy discussion has adequately addressed your concerns with the 2009 Framework. We believe that the proposed settlement is a good one that serves the interests of your clients and is faithful to the Swan Falls Agreement.

Sincerely,

CLIVE J. STRONG
Deputy Attorney General
Chief, Natural Resources Division

CJS/pb

Attachment

Via E-Mail and U.S. Mail
cc with attachment:

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SUMMARY
OF
SWAN FALLS REAFFIRMATION SETTLEMENT

Prepared by State of Idaho and Idaho Power Company

The 2009 Framework Reaffirming the Swan Falls Settlement (2009 Framework) sets forth the conditions for settling the current litigation. The terms "Framework" and "Reaffirming" are used intentionally to connote two key points. First, the 2009 Framework is a road map for reaching settlement rather than a final settlement document. Article II of the 2009 Framework describes the executive, legislative and judicial actions that collectively will constitute the settlement of the pending litigation and lays the foundation for cooperative resolution of other important issues. Second, the parties intend the proposed 2009 Reaffirmation Settlement to reconfirm rather than change any of the terms and conditions of the 1984 Swan Falls Settlement. This intent is reflected in the following language from the Framework:

> The parties through this Framework and its Exhibits reaffirm all aspects of the Swan Falls Settlement. This Framework and its Exhibits are consistent with the Swan Falls Settlement and clarify the original intent of the Swan Falls Settlement. Nothing in this Framework or its Exhibits changes, modifies, amends or alters any aspect of the Swan Falls Settlement.

2009 Framework Reaffirming the Swan Falls Settlement at 7. Thus, the parties intend that the 2009 Framework and its Exhibits will be interpreted in harmony with the 1984 Swan Falls Settlement.

The proposed 2009 Reaffirmation Settlement will resolve three issues regarding the interpretation of the 1984 Swan Falls Settlement. First, consistent with I.C. 42-203B, it will reaffirm that for the purposes of the determination and administration of rights to the use of the waters of the Snake River or its tributaries downstream from Milner dam, no portion of the waters of the Snake River or surface or ground water tributary to the Snake River upstream from Milner Dam are to be considered. As such, the hydropower water rights for the Idaho Power Company facilities located on the reach of the Snake River between Milner Dam and the Murphy Gage carry no entitlement to demand the release of natural flow past Milner Dam or to seek administration of the water rights diverting the waters of the Snake River or surface or ground water tributary to the Snake River upstream from Milner Dam. Second, it will reaffirm the Swan Falls Agreement by decreeing the hydropower water rights for Idaho Power Company's facilities between the Milner Dam and the Murphy Gage consistent with the SRBA District Court's Memorandum Decision and Order on Cross-Motions for Summary Judgment in Consolidated Subcase 00-92023(92-(23) dated April 18, 2008. Finally, it will reaffirm that the 1984 Swan Falls Settlement does not preclude use of water for aquifer recharge.

There are four Articles in the 2009 Framework Reaffirming the Swan Falls Settlement – each has a separate purpose.

Article I provides general background principles from the 1984 Swan Fall Settlement drawn from the 1984 Swan Falls Agreement, the 1984 Swan Falls Framework and the 1985 Idaho Water Resource Board resolution approving amendments to the Idaho State Water Plan that are relevant to the issues being resolved through the 2009 Reaffirmation Settlement. The fact that the 2009 Framework does not recite all of the provisions of the 1984 Swan Falls Settlement does not diminish the continuing importance or effect of other provisions of the 1984 Settlement. Rather, the 2009 Framework expressly reaffirms all aspects of the 1984 Swan Falls Settlement and does not alter or revise in any way the statutory provisions adopted as part of that Settlement, including but not limited to those provisions applicable to agriculture and the family farming tradition in Idaho.

Article II, as noted above, is the road map for resolving the current litigation. It provides for entry of partial decrees for the hydropower water rights at issue and for entry of an order dismissing Idaho Power Company's complaint, but only if the proposed legislation and Memorandum of Agreement are completed to the satisfaction of the State and Idaho Power Company. Assuming these actions are taken and the SRBA District Court enters partial decrees and a dismissal order acceptable to the State, Idaho Power Company and the other parties to Subcase 00-92023, the current litigation will be resolved. Otherwise, either the State or Idaho Power Company has the option of voiding the Framework and the proposed settlement and continuing the litigation.

Article III identifies certain issues that will be the subject of future discussions between the State, Idaho Power Company and other affected interests. The parties intend such discussions to be inclusive rather than exclusive. Moreover, nothing in Article III is intended to define the rights or obligations of any person, reinterpret the Swan Falls Settlement, or prejudice any party affected by such issues. For example, the reference to discussions regarding the establishment of an effective marketing system does not require any action by, or impose any obligations on, any person or entity. It is a commitment to have a good faith discussion of the issues associated with the water marketing issue and does not presuppose any particular outcome from such discussions. Likewise, the discussions regarding an acceptable program to monitor and measure flows at the Murphy Gage and procedures for re-evaluating term permits approved under Idaho Code § 42-203C do not contemplate any changes to the Swan Falls Settlement. Rather, these two issues, like the others identified in Article III, are illustrative of issues that warrant further discussion to determine whether an accord can be reached. Again, they do not presuppose any particular outcome from such discussions.

Article IV of the 2009 Framework contains general provisions relating to the intent and effect of the Settlement. This Article begins with the

> confirmation recited above that the Framework and its Exhibits reaffirm the Swan Falls Settlement and neither modify, amend or alter any aspect of the Swan Falls Settlement. The remaining provisions of the Article are generally recitations of provisions of the Swan Falls Settlement, including the recognition that "upon implementation of the conditions contained in Article II of this Framework, any subsequent order by a court of competent jurisdiction, legislative enactment or administrative ruling shall not affect the validity of the Framework or the Swan Falls Settlement." *Id.* at 8; and that "the Framework does not confer or create any additional vested, compensable or enforceable rights or interest of any kind whatsoever in any legislative enactments passed pursuant to this Framework beyond those rights otherwise available under applicable law." *Id.* at 8.

The proposed Memorandum of Agreement between the Idaho Water Resource Board, the Governor and Idaho Power Company sets forth an understanding between the parties regarding certain protocols for implementation of managed recharge. Like the 2009 Framework, the preamble language in the Memorandum is drawn primarily from the 1984 Swan Falls Agreement, the 1984 Swan Falls Framework and the 1985 State Water Plan amendments. Again, the recitation of some but not all of the provisions of these documents is not intended to diminish or alter in any way the importance, or effect, of other provisions of the 1984 Swan Falls Settlement. Rather, the provisions cited are intended to provide context for the substantive aspects of the Memorandum of Agreement and relating that Agreement to the provisions of the 1984 Swan Falls Settlement that are being clarified by the 2009 Settlement.

Three aspects of the Memorandum of Agreement warrant discussion. First, the Memorandum acknowledges that through the 1984 Swan Falls Settlement the State and the Company have a shared interest in ensuring that the Swan Falls minimum flows are maintained and recognizes that it is in their mutual interest to work cooperatively to explore and develop a managed recharge program that achieves to the extent possible benefits for all uses including hydropower. In this context, the Memorandum of Agreement memorializes Idaho Power Company's right to participate in the public process before the Board for evaluating and approving managed recharge as provided by state law and present information relative to any issues associated with a managed recharged proposal.

Second, the Memorandum acknowledges that the Idaho Water Resource Board adopted the Comprehensive Aquifer Management Plan (CAMP) and that the CAMP establishes a long-term hydrologic target for managed recharge from 150,000 to 250,000 acre-feet on an average annual basis and that any amendment of this long-term hydrologic target shall constitute a change in the State Water Plan. The Memorandum memorializes the Board's intent to implement managed recharge in phases and sets forth a protocol for phasing in managed recharge consistent with the adaptive management provisions of the CAMP. It further recognizes that the Board has discretion on how to implement the components of CAMP but provides the Board will seek legislative approval if it seeks to increase the CAMP Phase I recharge target of 100,000 acre-feet by

more than 75,000 acre-feet prior to January 1, 2019. Nothing in the Memorandum of Agreement, however, precludes the Board or the Legislature from changing how managed recharge is to be implemented provided they do so in accordance with state law.

Third, paragraph 5 of the Memorandum of Agreement provides that the Governor and the Idaho Water Resource Board will cooperate with and inform the Public Utilities Commission of any direct effects of managed recharge on hydropower generation capacity. This provision does not divest the Public Utilities Commission of its authority to independently evaluate Idaho Power's request. Rather, paragraph 5 is merely an extension of the recognition under the original Swan Falls Settlement and this Reaffirmation that the State should make informed decisions with regard to water management in an effort to enhance and manage the water supply in the Snake River for the benefit of agriculture, hydropower and other beneficial uses. Consistent with that recognition, Paragraph 5 provides that upon making such an informed decision with regard to the implementation of managed recharge, the Governor and the Board will so inform the Public Utilities Commission of any "direct impacts" they determine may arise from implementation of managed recharge and acknowledge that such impacts may have an effect on the Company's ability to provide electrical energy. Paragraph 5 of the Memorandum does not require the Governor or the Board to take any affirmative position on whether a specific request by the Company is appropriate or necessary or on how any resulting rate impact should be allocated.

Senate Bill 1167 proposes that managed recharge projects be subject to the same review process applicable to storage reservoirs under Idaho Code § 42-1737 because managed recharge may have effects on surface flows similar to those of a storage reservoir. The bill does not apply to incidental recharge.

Senate Bill 1185 clarifies that the Swan Falls Agreement does not preclude use of water for recharge by removing the reference to the Agreement in Idaho Code § 42-234 and repealing Idaho Code § 42-4201A. In addition, this bill would consolidate state recharge policy in Idaho Code § 42-234. The parties anticipate amending this bill or submitting a substitute bill that will clarify the intent of subsection 3 of Senate Bill 1168.

Senate Bill 1169 reconfirms that the Company by reaffirming the 1984 Swan Falls Settlement is entitled to the same protection as contained in the uncodified provisions set forth in Chapter 14 of the 1985 Idaho Session Law at page 20-21. Because this Reaffirmation Settlement is an extension of the original Swan Falls Settlement, this bill is not intended to create any new or additional benefits for Idaho Power Company that do not already exist as a result of Chapter 14 of the 1985 Idaho Session Laws, it merely clarifies that the same protections afforded to Idaho Power by the 1985 legislation are extended to this reaffirmation settlement. This bill does not deprive the Public Utilities Commission of authority to independently determine the necessity or reasonableness of any of any rate request by Idaho Power Company.

The form of the partial decrees of the hydropower water rights are attached as Exhibit 6 to the 2009 Framework. The language of these decrees is consistent with the resolution of the three issues discussed above. In addition, the decrees recognized the

subordination provisions contained in the 1984 Swan Falls Agreement and the 1180 Contract executed as part of the 1984 Swan Falls Settlement.

In summary, the State and Idaho Power Company believe the terms of the proposed 2009 Reaffirmation Settlement are entirely consistent with the 1984 Swan Falls Settlement and provide an opportunity for the parties to set aside their differences and work in a cooperative manner to resolve other Snake River water management issues.