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U.S. Department of the Interior, Bureau of Reclamation

BEFORE THE DEPARTMENT OF WATER RESOURCES

OF THE STATE OF IDAHO

IN THE MATTER OF DISTRIBUTION OF WATER TO VARIOUS WATER RIGHTS HELD BY OR FOR THE BENEFIT OF A&B IRRIGATION DISTRICT, AMERICAN FALLS RESERVOIR DISTRICT #2, BURLEY IRRIGATION DISTRICT, MILNER IRRIGATION DISTRICT, MINIDOKA IRRIGATION DISTRICT, NORTH SIDE CANAL COMPANY, and TWIN FALLS CANAL COMPANY	)	**RECLAMATION'S POST-HEARING BRIEF**

COMES NOW the U.S. Bureau of Reclamation, by and through counsel of record and submits the following Post-Hearing Brief for the purpose of clarifying the legal and factual issues that were heard at hearing in this case. Reclamation's Post-Hearing Brief is supported by its *Findings of Fact and Conclusions of Law* submitted herewith.

INTRODUCTION

This case presents numerous issues. The Surface Water Coalition (Coalition), ground water users, and City of Pocatello will no doubt argue the full gamut of issues in their respective briefs. In its brief, Reclamation will focus primarily on the issue of reasonable carryover storage.

This narrow focus is appropriate given that the issue of reasonable carryover is arguably the most significant issue in this case in terms of the large volume of water at

stake, the possibility of gross disparities and windfalls, immediate and long-term impacts, and the potential for unintended consequences. The discretion to impose "reasonableness" limitations on carryover storage allows the Director to effectively reallocate large amounts of storage water from senior surface right holders to junior ground water users. It is accomplished with the stroke of a pen. And because the transaction involves water to meet future needs, the impacts are not readily apparent—but they are nonetheless immediate, real and significant.

At its core a limitation on carryover—whether labeled "reasonable," "proper," "prudent," "sensible," or whatever adjective one chooses—is simply a reallocation tool. It creates no new water. It takes water historically destined for one set of water users and gives it to another set of users. This redistribution of water necessarily increases the risk of shortage (or curtailment) on one set of users and reduces the risk of shortage (or curtailment) on another. Market forces play no role in this redistribution of risk and property interests. Under the conjunctive management rules, this task of redistribution falls to a central authority, the Director. Resolution of the reasonable-carryover issue hinges on two questions: (1) in light of the unique history surrounding the development of carryover storage in the Upper Snake River Basin combined with increased prospects of future severe drought and limited water supplies, are limitations on carryover in the upper basin improper under Idaho law? (2) even if some limitation on carryover in the Upper Snake River Basin is allowed under Idaho law, are the limitations ordered by the Director unreasonable or otherwise arbitrary and capricious? The issue of reasonable carryover is examined below.

DISCUSSION

1. THE DIRECTOR'S LIMITATION ON CARRYOVER STORAGE IS UNREASONABLE.

(a) The Discretion to Impose "Reasonableness" Limitations on Carryover is Limited.

In *AFRD # 2 v. Idaho Dep't of Water Resources,* the Court ruled that the Director's discretion in imposing reasonableness limitations on carryover storage is limited:

> Somewhere between the absolute right to use a decreed water right and an obligation not to waste it and to protect the public's interest in this valuable commodity, lies an area for the exercise of discretion by the Director. This is certainly not unfettered discretion, nor is it discretion to be exercised without any oversight. That oversight is provided by the courts, and upon a properly developed record, this Court can determine whether that exercise of discretion is being properly carried out.

143 Idaho 862, 880 (2007). With these limitations in mind, the Director's reasonable carryover determinations are examined.

(b) There Exists an Increased Risk of Future Water Shortages in the Upper Snake River Basin.

Carryover storage is inextricably tied to the future. *See e.g., AFRD # 2*, 143 Idaho at 880. It is always forward looking. It is about storing water in a reservoir today for later withdrawal during future dry years. Consequently, any meaningful discussion of carryover must include an assessment of future water supply conditions. If the future looks wet, the argument for carryover diminishes. Conversely, the prospects of a drought-plagued future, like the one forecasted for the Colorado River basin states, places a premium on carryover storage. So what are the future prospects for the Upper Snake River Basin in terms of water availability?

Evidence at trial leaves little room for optimism. Even if we ignore the potential consequences of global warming or assume global climate changes will not impact the Upper Snake River Basin (however unwise that may be), there are already several factors working against future water availability in the basin: a history of severe and prolonged droughts, increased variability of flows, and latent ground water depletions.

The first factor recognizes the fact that the Upper Snake River Basin is prone to cycles of severe and prolonged droughts. During the most recent 80-year time span, from the 1930's through 2007, the basin experienced several prolonged, severe droughts. *Tr. Vol. II, p. 498, LL. 3-16.* The first among these occurred during the early 1930's causing substantial crop losses totaling nearly $11,000,000. *Exhibit 7001, Report of the Regional Director, p. 5-6; Exhibit 7001, Substantiating Report, p. 6.*[1] This drought prompted the construction of a large carryover reservoir in the Grand Valley, later known as Palisades. *Id.* The other two drought cycles occurred in 1987 to 1994 and 2000 to 2004. *Tr. Vol. V, p. 937, LL. 22-25, p. 938, LL. 1-5.* When questioned about the risk of future multi-year droughts, Lyle Swank, the watermaster for Water District 01, testified:

> Well, over my career, 1987 to '94 was a pretty severe drought, with a couple of high precipitation years within that time period. And then, again, from 2000 to 2004, early 2005, was another pretty severe long-term drought. So statistically, if it's happened in the past, it certainly could happen again.

Tr. Vol. V, p. 937, LL. 22-25, p. 938, LL. 1-5. Similarly, when questioned whether the Upper Snake River Basin would experience dry years in the future, former Director Dreher was more emphatic: "Undoubtedly." *Tr. Vol. II, p.311, L. 13.*

[1] The Palisades planning report (Exhibit 7001) actually consists of two reports: the Report of the Regional Director and the Substantiating Report. To avoid confusion, citations to Exhibit 7001 will indicate whether it is to the Regional Director's report or the Substantiating Report.

Increased variability--the second factor—is a relatively new phenomenon. As testified to by Reclamation's expert, Dr. Raff, during the last two decades the variability of water supply in the upper Snake River has increased. *Pre-Filed Expert Testimony of David A. Raff, Ph.D., p. 9-10, Figure 6.* This increase in variability means the wet years have become wetter and the dry years have become dryer. *Id. p. 9.* Former Director Dreher echoed this conclusion:

> MS. CARR: And in the deposition we talked about the Heise flows appearing to become more variable?
> MR. DREHER: That's correct.
> Q: And you agree with that?
> A: I agree with that.
> Q: And does that mean to you that the dry years are becoming dryer and the wet years are wetter?
> A: That's one way to view it, and generally that's true, but if you look at the – the- using the Heise Gage, for example, the largest year of unregulated inflow was 1997. And if you look at the same location, the – the lowest year of unregulated inflow is 1977, which would be consistent with higher – higher highs and lower lows during this period of increased variability.

Tr. Vol. II, p. 331, LL. 23-25, p. 332, LL. 1-15. Viewed in the abstract, wetter and dryer years should not pose a water supply problem. The wetter years should simply cancel out the dryer years.

In reality, increased variability translates into a greater risk of future water shortages. *Pre-Filed Expert Testimony of David A. Raff, Ph.D., p. 9.* This is because the increased wetness cannot be stored due to the finite size of the upper Snake River reservoir system. *Id.* Thus, while the fixed capacity of the reservoir system prevents storage of excess precipitation during wet years, the opposite is not true. The surface water irrigators must absorb the full hit of Mother Nature during dry years and are limited by the capacity of the reservoir system in wet years. According to former Director

Dreher, none of us should be surprised to see the consequences of increased variability unfold in the future:

> Well, based upon the variability that we're seeing, I don't think we should be surprised to see wetter years than we've seen in the past and dryer years than we've seen in the past.

Tr. Vol. II, p. 498, LL. 21-25.

The third factor that militates against future surface water availability is the problem of latent ground water depletions in the Eastern Snake Plain Aquifer. These are the depletions that have already occurred as a result of ground water pumping but because of the time lag involved, these depletions have not yet manifested themselves as reduced reach gains in the Snake River. Latent ground water depletions are those depletions that are caught in the time lag between the cause (depletion resulting from ground water pumping) and the effect (reduced reach gains to the Snake River). They are real future impacts. They just have not showed up in the river yet.

In his testimony, Mr. McGrane, a professional engineer who oversees Reclamation's River and Reservoir Operations Group for the Pacific Northwest Region, testified that as of 2005 ground water pumping was depleting the Snake River above Minidoka dam by approximately 1,379,000 acre feet per year. *Pre-Filed Expert Testimony of Patrick C. McGrane, P.E.*, pp. 7-8. That means as of 2005, there was approximately 1.4 million acre-feet less water in the Snake River due to ground water pumping. Moreover, it is an annual amount. That amount of water or more that will continue to be depleted from the Snake River every year absent changes to ground water pumping. *Id.*

But for purposes of assessing future water supplies, it is the latent depletions in the "pipeline" that must not be overlooked. According to Mr. McGrane, there is still approximately another 142,000 acre-feet per year of ground-water-pumping depletions that have yet to be manifested in the form of reduced reach gains in the Snake River above Minidoka and 200,000 acre feet of latent depletions above King Hill. *Id.* At trial, Mr. McGrane explained this impact in further detail:

> But I think if you look at my report, and it says 10 percent of the effect is yet to be felt, and 10 percent roughly of 1.4 million acre-feet above Minidoka is yet to be felt, that should tell the hearing officer that there's problems out there in the future, and we've still got roughly 200,000 acre-feet of depletions in the pipeline, so to speak. The gains, if you want to call them that, are going down another 200,000 acre-feet in the future [above King Hill].

Tr. Vol. VII, p. 1424, LL. 14-23; Tr. Vol. VII, p. 1432, LL. 11-25, p. 1433, LL. 1-7.

The three strikes against the Upper Snake River Basin—an area prone to severe and prolonged droughts, increased variability, and latent ground water depletions—leave little room for optimism in terms of future water supply conditions. Any reasonable assessment of future water supply conditions must include the real likelihood that the worst is yet to come for the upper basin. The risk that irrigators will have to endure future water shortages of greater severity has increased. It is within this future context that the reasonableness or unreasonableness of limiting carryover storage must be examined.

(c) The Risk of Future Water Shortages in the Upper Snake River Basin Has Been Managed Through Development of Carryover Storage.

The risk of future water shortages is not new to surface water irrigators in the Upper Snake River Basin. Perhaps not too unlike other desert civilizations, the upper Snake River irrigators have learned how to adapt to their environment. They have

developed a large, viable agricultural community that has existed in a drought-prone climate for over 100 years. Evidence at trial demonstrated that one of the keys to maintaining a viable surface-water-irrigated farming community in the Upper Snake River Basin is adequate carryover storage: The ability to carry over a sufficient quantity of water from wet years for use during dry years. The need for adequate carryover storage was a painful lesson learned by the early irrigators of the upper basin.

According to the Bureau of Reclamation's 1946 Palisades Project Planning Report, irrigators believed they had finally secured adequate storage following the 1927 construction of American Falls Reservoir, the largest reservoir on the Upper Snake River with an active capacity of 1.7 million acre-feet. *Exhibit 7001, Report of the Regional Director, p. 5.* So confident were they of their triumph over nature that only three-fourths of the reservoir was dedicated to supplement existing lands; one-fourth of the storage was set aside to develop new lands. As explained in the Palisades Project Planning Report:

> The drought in 1919 and the ensuing concerted action by the water users resulted in the construction of American Falls Reservoir in 1927. Stream flow records up to that date indicated that the reservoir would fill during every year; and that, in combination with storage already available in Jackson Lake, three fourths of the capacity of the American Falls Reservoir would meet all the needs of existing projects. Accordingly, only three fourths of the American Falls storage space was assigned to existing irrigation projects. The remaining capacity was reserved for development of new land.

Exhibit 7001, Report of the Regional Director, p. 5. The surface water irrigators were caught off guard by the unprecedented drought of the 1930's:

> An unprecedented drought which began in 1929 caused serious water shortages on the existing projects and gave rise to the fear that even the augmented water supply [from American Falls Reservoir] was not adequate. All plans for development of new land were temporarily laid aside, and the reserved space in American Falls was leased to the existing projects in 1931. Even with full use of American Falls Reservoir, most of the existing projects suffered serious water shortages in 1931, 1934, and 1935.

Id.

The severe water shortages, crop losses, and millions of dollars of lost revenues experienced during the 1930's drought exposed a serious weakness: lack of adequate carryover reservoir space. After nearly a decade of studies by the Bureau of Reclamation, numerous public meetings, and a full week of congressional hearings which included testimony from Idaho's congressional delegation, Reclamation officials, the watermaster of the Upper Snake River, and the irrigators, Congress authorized the construction of Palisades Reservoir. *See e.g., Exhibit 7006; Exhibit 7008; and Act of September 30, 1950, Pub. L. No. 864, 64 Stat. 1083.*

Unlike its predecessor—American Falls Reservoir, which was constructed to provide a base supply of water and for irrigation of new lands—Palisades Reservoir was constructed primarily for the purpose of providing carryover storage:

> The primary objective of the project is to provide hold-over storage during years of average or above-average precipitation for release in ensuing dry years to lands of the Upper Snake River Valley—the area served by diversions from the river above Milner Dam.

Exhibit 7008, p. 15. The usefulness of Palisades Reservoir as a hold-over supply, as opposed to a primary base supply of water, like American Falls, was explained well in a 1954 letter from the Regional Director of the Bureau of Reclamation to the attorney for the Salmon River Canal Company:

> Palisades was planned to provide an insurance supply of water to lands now irrigated. Our water supply studies have indicated that construction and operation of Palisades Reservoir will reduce prospective shortages during the critical period [referring to the extended drought of the 1930's] by 1 acre-foot for each 3 acre-feet of active space in the reservoir.
>
> . . .

> It is because of the nature of the yield of Palisades space that we have encouraged its use as a supplemental supply for districts having Snake River rights and already having a full supply except during the period of critical flows. . . . In the case of the Michaud Flats Project and the North Side Pumping Division,[2] where we have proposed to use Palisades space for new land, we will combine it with the firm-yielding American Falls space. Used in this manner Palisades becomes an insurance supply to back up the American Falls space during the critical [drought] period.

Exhibit 7012, pp. 1, 2, 3-4. The beneficial use of storing carryover water in Palisades Reservoir was subsequently confirmed by the State Engineer and Idaho Legislature during the water right licensing process for the reservoir. *See e.g., 7013, 7015, and 7016.*[3]

Viewed in the proper historical context, Palisades Reservoir was constructed as a means to manage and offset the risk of future dry years. Palisades provided the upper Snake River irrigators with an indispensable tool for reducing the risk of future of water shortages. With the ability to capture carryover water in Palisades, the risk of future water shortages was reduced, as well as the risk that when those shortages did occur the severity would be reduced. *See e.g., Exhibit 7005, pp. 11-12; and Pre-Filed Expert Testimony of David A. Raff, Ph.D., p. 3-4.*

Equally important, Palisades represents an expression of public policy by federal, state, and local officials that carryover storage in the Upper Snake River Basin is both necessary and beneficial. The public and private financial commitment to carryover storage in the upper basin was no small matter. With an active capacity of 1.2 million acre-feet, Palisades is second in size only to American Falls. *Tr. Vol. VI, p. 1179, LL. 21-*

[2] The North Side Pumping Division is more commonly known as the A&B Irrigation District. *See* Tr. Vol. VI, p. 1183, LL. 5-9.

[3] A more complete discussion of the actions of the State Engineer and Idaho Legislature relative to the licensing of Palisades is set out in Reclamation's Trial Brief (Dec. 21, 2007). To avoid unnecessary redundancy, Reclamation incorporates herein by reference its trial brief.

22, p. 1180, LL. 23-25. In light of the detailed history, policy considerations, and expenditures made to develop adequate carryover storage in the upper basin, attempts to limit carryover should be scrutinized carefully with a full appreciation in mind of the history and rationales leading up to development of Palisades. The admonishment of early Twentieth Century poet and philosopher George Santayana bears repeating: "Those who cannot remember the past are condemned to repeat it."

(d) The Director's Attempt to Reallocate or "Balance" Risk through Limiting Carryover Storage Runs Afoul of Idaho Law.

While no doubt well-intentioned, the Director's self-described effort to "balance" risk by limiting carryover, *Tr., Vol. II, p. 312, L. 17,* amounts to a leap of faith into an abyss filled with unknowns and is ultimately at odds with Idaho law. Before accepting the invitation to step off the precipice, closer scrutiny of the Director's "balanced-risk" approach is merited. To avoid muddying the waters, however, one central fallacy or red herring alluded to by opposing counsel during trial must be addressed.

The fallacy is the notion that the Director's reasonable carryover determinations somehow do not limit carryover. During his testimony, former Director Dreher explained what was meant by "reasonable carryover storage":

> MR. DREHER: [Reasonable carryover storage] is not a limitation on how much an entity can carry over. It's a limitation on how much of the carryover storage should be provided through curtailment or replacement water in lieu of curtailment.

Tr. Vol. II, p. 312, LL. 3-7. A helpful analogy, perhaps, is to consider the Director's above-quoted testimony in terms of a paycheck and savings account. The Director is placing no direct limits on the amount of money that can be put into savings account. The focus is on the paycheck. If the paycheck is for $150, the Director may determine

that amount is excessive and that $50 constitutes a reasonable amount needed to be placed into savings to offset future financial shortfalls. The Director will prevent (or curtail) third parties from intercepting this first $50. But the remaining $100 is subject to no protection from other individuals who, in need of money, grab it up. The net effect, though, is that the savings account has been limited by $100. Had the Director protected the full amount of the paycheck, there would have been $150 in the savings account. Instead, the Director by his actions has limited the savings account to $50.

Similarly, by refusing to curtail junior users, who are intercepting water otherwise destined to be captured in carryover reservoir space under a senior priority water right, the Director is placing a limit on carryover storage. While the merits and legality of imposing this sort of limit on carryover storage will be explored further, what cannot be ignored is the reality that the Director's reasonable carryover determinations impose a very real limitation on carryover storage.

The Director's balanced-risk approach will now be examined. As discussed in greater detail in Reclamation's *Trial Brief*, carryover storage and risk are two sides of the same coin. They are inseparable. Increase carryover storage (by constructing a new reservoir) and the risk and severity of future water shortages decreases. This is precisely the purpose for—and the effect of—constructing Palisades Reservoir in the Upper Snake River Basin. *See discussion, supra.* Conversely, the risk of future shortages (and the risk that future shortages will be more severe) increases, if carryover storage is reduced or limited. This is precisely the purpose for—and effect of—the Director's reasonable carryover limitations. These conclusions are supported by the expert testimony of

Reclamation's expert, Dr. Raff. *See e.g., Pre-Filed Expert Testimony of David A. Raff, Ph.D., P.E.*.

Admittedly, it seems a bit harsh to accuse the Director of purposely and intentionally increasing the risk of future shortages on the Coalition farmers. But that is the reality. The Director did it with the best of intentions and with a clear understanding of what he was trying to accomplish, namely, to "balance risk" between senior and junior users in times of a call. *Tr. Vol. II, p. 312, LL. 13-18.* By imposing a "reasonableness" limitation on carryover storage, the Director is able to take some of the risk of loss off of the junior ground water user (who would otherwise have to mitigate for depletive impacts to carryover storage) and place that risk of loss, *i.e.,* future water shortages, onto the senior water right holders, who are now left with reduced carryover storage to combat future droughts.

Not unlike Justitia, the Roman goddess of justice, holding the scales of justice in her left hand, the Director took what he believed to be a disproportionate amount of risk on the junior ground water users and redistributed it onto senior surface water users until, metaphorically speaking, the scales struck what he believed was a proper balance of risk to allow for optimal or maximum utilization of the resource. *See e.g., Tr. Vol. II, p. 312, LL. 8-25, p. 313, LL. 1-24.*

This is the point, however, where the Director's balanced-risk approach runs afoul of Idaho law. In *AFRD # 2,* the Court recognized there is a line between legitimate reasons to carry over storage water, *i.e.*, for "future needs" versus illegitimate purposes for carrying over water such as hoarding or waste without regard to future beneficial use of the water. *See e.g., AFRD # 2*, 143 Idaho at 880. The Director was given the task of

drawing the line between storage water for future needs versus excess carryover storage. *Id.* Pursuant to *AFRD # 2*, the Director is given discretion to "determine whether carryover water is reasonably necessary for future needs." *Id.* Under *AFRD # 2*, the proper inquiry is the future-needs inquiry: Whether carryover storage water is necessary for future needs of the senior Coalition farmers. The Court did not authorize the Director to redistribute and balance risk among senior and junior users.

The Director's desire to redistribute and balance risk is neither new nor inherently wrong. By injecting values of fairness and vagaries of reasonableness, which necessarily underlie his risk-balancing approach, the Director has set the state's feet upon a path well trodden by the doctrine of riparianism. Riparianism is imbued with the qualities of fairness, equity, and reasonableness. 2 HUTCHINS, WATER RIGHTS LAWS IN THE NINETEEN WESTERN STATES, 23-25 (GPO)(1974). But it is not without problems. Determining what is *fair* is infinitely more complex and subjective than determining who was *first*. And therein lies the critical distinction between riparianism and the prior appropriation doctrine. In 1890, the Idaho Supreme Court, in *Drake v. Earhart*, revisited the issue of riparianism-versus-prior-appropriation. In affirming the prior appropriation doctrine, the Court offered a reminder as to why the priority doctrine is preferable to its equitable counterpart in this arid region:

> Whether or not it is a beneficent rule, it is the lineal descendant of the law of necessity.
>
> . . . The demand for water [the settlers] found greater than the supply, as is the unfortunate fact still all over this arid region. Instead of attempting to divide it among all, thus making it unprofitable to any, or instead of applying the common-law riparian doctrine, to which they had been accustomed, they disregarded the traditions of the past, and established the only rule suitable to their situation that of prior appropriation.

Drake, 2 Idaho 750, 753-54 (1890).

Not only does the Director's risk-balancing approach run afoul of *AFRD #2*, but it also—with the best of intentions—steers the state down a path long ago that *Drake* cautioned against. Importantly, the Director's reasonable carryover limitations do not produce an overall reduction in risk of future water shortages. They simply shift some of the risk from the junior users onto the senior water users based on the Director's sense of what constitutes a fair balance. The legal question, of course, is whether *Drake* and its progeny will remain intact or whether Idaho will open a new chapter where a central authority is given some discretion to balance risks and allocate water accordingly.

Aside from the legal question is the question of future needs. Carryover storage, by definition, is concerned only with future needs. Determining how much water will be needed in the future and the amount of carryover storage needed today can be precisely calculated. This formula requires answers to several difficult questions. When will the next drought year occur? Will it be consecutive years of drought? How severe will the drought be? Prescience is essential to answering these questions with any helpful degree of precision, yet lacking. When questioned whether there will be future dry years in the Upper Snake River Basin, former Director Dreher testified emphatically that there will be severe periods of drought in the future, especially in light of the problem of increased variability (*see discussion, supra*). *Tr. Vol. II, p.311, L. 13, p. 498, LL. 21-25.* Few could disagree with former Director's assessment. We are all reasonably confident future dry years will occur and that they will likely be more severe than what we have experienced to date.

We lack knowledge, however, of two critical components: timing and severity. We know severe droughts will occur, but we do not know when they are going to occur or how bad they will be—other than we expect them to be worse. Without this information neither the Director (nor anyone else for that matter) can determine how much carryover storage is actually needed to be captured in the reservoirs today to satisfy future water needs: all, some or none of it.

That conclusion brings us full circle—back to balancing risk. The former Director certainly knew he could not predict the timing or severity of future droughts, but he could redistribute risk between junior and senior users and arrive at what he believed to be a fair balance. Putting aside for a moment the legal implications of risk balancing, is it wise or practical to vest in a central authority, like the Director, the power to redistribute risk among individuals? If we accept, as we must, that we are equally blind to the future, then we are all equally capable of making bad or erroneous judgments about the future.

The question is who should be placed in the position to make the bad decision: A central planner or the individuals? It is one thing to live with a bad decision we make; it is quite another to live with a bad decision someone else makes for us, especially in the arena of redistributing risk and private property interests. If left to individuals, the market typically serves as the medium for reallocation of risk until equilibrium is reached. Under the market process, individuals, not a central planner, redistribute risk of future loss.

As the evidence at trial demonstrated, market mechanisms are already at work in the Upper Snake River Basin. Junior ground water users have proven to be extremely

resourceful in finding market solutions when faced with the risk of curtailment. They have entered into storage rentals from the rental pool, executed dry-year lease agreements, and facilitated exchanges with below-Milner high-lift pumping rights. *See e.g., Exhibit 4143.* The City of Pocatello, which holds 50,000 acre-feet of space in Palisades Reservoir, further profited by leasing some of its storage water to the ground water users in 2007, while also attempting to lease an additional 10,000 acre-feet to Idaho Power Company for power generation below Milner. *Exhibit 7024 (Letter from Mayor Chase to Director Tuthill regarding lease to Idaho Power and approval of lease request to Idaho Water Resources Board).* As a practical matter, few would dispute that market mechanisms are better suited to redistribute risk and property interests among individuals—and, in this case, have the added benefit of not running afoul of *Drake* and *AFRD # 2*. There is no evidence to suggest that market mechanisms cannot work in this case if no limitations on carryover were imposed.

There is also the matter of unintended consequences associated with imposing limitations on carryover. On the surface, a limitation on carryover storage shifts some of the risk of shortage from the junior users to the senior users. Unintentionally, though, it has a more insidious effect. It creates a disincentive for the junior ground water users to want to invest in long-term improvements of the surface water system in the Upper Snake River Basin. Imposing limitations on carryover storage is equivalent to a subsidy. Because it reduces the risk of curtailment on junior users, they lack incentive to contribute towards improvements in excess of their risk. This will have an effect on the ground water users' willingness, for example, to help fund some of the expensive water supply projects being suggested to the Governor. For example, at trial, Jerry Gregg,

Reclamation's Snake River Area Manager, testified about the current proposal and costs for raising Minidoka Dam:

> MS. CARR. Mr. Gregg, before break we talked a little bit about augmenting flow, building a new storage reservoir or something in the Upper Snake River Basin. Are you talking about specifically the raising of Minidoka Dam; is that what you are looking at, or what's the option?
>
> MR. GREGG. That's one proposal, is to raise—we need to replace the spillway. In round numbers that's a 40 to 50 million dollar project. That water users and the State would like to look at raising [it] some . . . five feet to between 40,000 and 50,000 acre-feet of additional storage.
>
> In very round numbers, that's probably about a 160 million dollar project, or about $3,300 per acre-foot of construction costs. Of course, the water users are asking the Governor in his budget for 1.4 million to do a feasibility study to see if it's feasible and what the exact costs would be.

Tr. Vol. VI, p. 1235, LL. 23-25, p. 1236, LL. 1-17.

Conversely, imposing limitations on carryover has the opposite effect on the senior surface water users. Burdened with an increased risk of shortage, they now have a greater incentive to contribute towards improvements in the water supply system, such as Minidoka Dam. This leads to a different unintended consequence: An inadvertent windfall to the junior ground water users. The senior users have previously contributed to the construction of the existing Reclamation reservoirs in the Upper Snake River, *e.g.*, Jackson Lake, Minidoka, American Falls, Island Park, Grassy Lake, and Palisades, and they continue to pay yearly operation and maintenance costs for those facilities. *Gregg, Tr. Vol. VI, p. 1195-1196, LL. 15-8.* And now, because of the increased risk of future shortage associated with reasonable carryover limitations, they are potentially forced into a position of carrying a disproportionate financial burden in terms of funding future water supply projects, such as the raising of Minidoka Dam. In very practical terms, this case is about money as much as it is about water. However, the Legislature,

not the Director, should be the one responsible for apportioning relative incentives and disincentives for construction of future water supply projects.

(e) The Director's Single-Year Limitation on Carryover Violates the Conjunctive Management Rules.

Aside from the balanced-risk approach, the director's reasonable carryover determination suffers from a second fatal flaw. It violates Rule 42 of the conjunctive management rules. The rules clearly provide that a storage right holder is entitled to maintain sufficient carryover storage to assure water supplies for multiple dry years:

> . . . the holder of a surface water storage right shall be entitled to maintain a reasonable amount of carry-over storage to assure water supplies for future dry years.

IDAPA 37.01.11.042g (emphasis added). Use of the plural "dry years" instead of the singular "dry year" leaves no room for doubt that the purpose of carryover storage, as contemplated by the rules, is to provide insurance water for multiple dry years. As detailed in *Reclamation's Trial Brief*, which is incorporated herein by reference, the director has improperly limited supplies of carryover to a single year. *See Trial Brief at 3-6.* On this basis, alone, the director's limitations on carryover storage are arbitrary and capricious.

(f) The "Timing" for Mitigation of Reasonable Carryover is Arbitrary and Capricious.

A separate issue concerns the timing for mitigation of reasonable carryover shortfalls. As shown in *Reclamation's Trial Brief*, the entire mitigation-for-reasonable-carryover-shortfalls process is illusory. *See Trial Brief at 16-19.* Following the logic of the Director's orders, mitigation for reasonable carryover shortages is limited to three options: (1) It is merged into the following year's material injury determination; (2) It is

carried over as a debit/credit to the following year; or (3) It is cancelled because the affected reservoir space fills. Under any of these options, mitigation for reasonable carryover is never paid.

Testimony at the hearing, however, revealed a clear difference of opinion between the current Director and former Director Dreher on this issue. Former Director Dreher testified that it was his intent to have payment for reasonable carryover shortfalls made in the same year that the shortfall occurred:

> MR. BROMLEY. And for purposes of reasonable carryover, when, under your methods, were you envisioning that to be owed or due?
>
> MR. DREHER. Certainly, during the irrigation [year] prior to the subsequent year. So in 2005 the amount for reasonable carryover would have been due during that irrigation season so that both sides, the ground water folks and the surface water folks, would know going into 2006what they had.
>
> And at least my intent was that if the amount necessary to provide reasonable carryover was not provided in 2005, that there would be some level of curtailment in 2006.

Tr. Vo. I, p. 103, LL. 11-23. Director Dreher testified there were two reasons for requiring mitigation of reasonable carryover upfront: (1) without payment of carryover water irrigation district managers would face greater uncertainties as to the next year's supply, and (2) if you wait until the following year, there may not be any extra water available to provide:

> MR. SIMPSON. And without—without some identifiable carryover, those managers in planning would face greater uncertainties as to what next year's water supply would be; correct?
>
> MR. DREHER. Yeah, that's correct. And the reason for that is because if – if you wait until the subsequent irrigation year – in the case of the May 2d order, it would be the year 2006. If you wait till 2006 to attempt to provide reasonable carryover, there may or may not be water available to provide. So that's why I felt it was important that the carryover storage to be provided for 2006, be provided during the irrigation season of 2005.

Tr. Vol. II, p. 269, LL. 22-25, p. 270, LL. 1-10.

In his *Seventh Supplemental Order Amending Replacement Water Requirements* issued on December 20, 2007, the current director expressed a course of action directly at odds with his predecessor:

> IGWA will not be required to provide reasonable carryover water to members of the Coalition until after the USBR and USACE joint operating forecast is issued and at such time as it is needed by members of the Coalition.

Seventh Supplemental Order, Conclusion of Law # 7. Under the current Director's order, the replacement water for the 2007 reasonable carryover shortfalls never gets paid. It falls into one of the three options described above. The timing issue should be resolved with one of two possible approaches. One approach would be to follow the process as outlined by the former Director Dreher. Under that process, mitigation for reasonable carryover shortfalls had meaning and substance. Real water was paid in the year of the shortfall. Alternatively, the second approach is to deny the Coalition entities any right to receive mitigation for their reasonable carryover shortfalls. While the latter approach is not advocated, it would at least be transparent. The current Director's order lacks the virtue of either approach.

2. THE DIRECTOR ABUSED HIS DISCRETION WHEN HE DID NOT FOLLOW THE CONJUNCTIVE MANAGEMENT RULES THAT REQUIRE MITIGATION PLANS.

(a) The Supreme Court Required the Director to follow all Parts of the Conjunctive Management Rules.

In *AFRD #2*, 143 Idaho at 875, the Supreme Court acknowledged that the Director must be able to "exercise some discretion" in how he responds to a delivery call as provided by the Conjunctive Management Rules. Presumably, the Director also has "some" discretion under the rules in how water may provided to satisfy the water rights

subject to the delivery call. However, as originally provided in his *May 2nd Order, pp. 45-47 (Exhibit 3009)*, and most recently recognized through the *Seventh Supplemental Order Amending Replacement Water Requirements (Exhibit 4600)*, the Director exercised more than "some" discretion when he completely dismissed the mitigation provisions of the Conjunctive Management Rules and created his own legal methodology that he defined as 'replacement water plans', and it all occurred without benefit of rulemaking.

If the Director had exercised discretion in how he interpreted particular provisions of those Conjunctive Management Rules, he should be given deference if his interpretation was not arbitrary and capricious. *AFRD #2,* 143 Idaho at 446. But in this case, the Director did not adhere to *any* of the mitigation provisions of the Conjunctive Management Rules. Since the Director's replacement methodology was not undertaken pursuant to the state's rulemaking procedures, it cannot be given any legal effect and must be considered an abuse of discretion as a matter of law. I.C. § 67-5279(3)(3), and *see, Asarco Inc., v. State*, 138 Idaho 719, 69 P.3d 139 (2003)(to have the force and effect of a rule, agency action must be promulgated according to statutory directives for rulemaking).

(b) The Conjunctive Management Rules Were Promulgated as Rules.

In contrast, since the Department's Conjunctive Management Rules were undertaken pursuant to Idaho's APA, including being published with notice and comment, and were enacted as approved rules by the Idaho legislature, *see* I.C. §§ 67-5220 to 5225, the rules should be followed to the extent they are not proven unconstitutional in an-as-applied challenged. *See AFRD #2,* 143 Idaho at 867 (The Legislature has not rejected, amended or modified any part of the Rules and they have,

therefore, remained in effect as written). The Conjunctive Management Rules define a "mitigation plan" as any:

> [D]ocument submitted by the holder(s) of a junior-priority ground water right and approved by the Director as provided in Rule 043 ... identifies actions and measures to prevent, or compensate holders of senior-priority water rights for, material injury caused by the diversion and use of water by the holders of junior-priority ground water rights within an area having a common ground water supply.

See IDAPA 37.03.11.010.15 (definition of "mitigation plan"). The Director recently stated he wanted just that when he said:

> [T]he Idaho Ground Water Appropriators, Inc. shall be required to provide the Director with a signed lease or leases demonstrating that it has secured 14,345 acre-feet of water to compensate the Twin Falls Canal Company for the 17,345 acre-feet of material injury predicted to have occurred in 2007.

Seventh Supplemental Order Amending Replacement Water Requirements, at 9 *(Exhibit 4600)*. The Director identified actions and measures that IGWA could take to prevent injury and he identified the compensation (water) that should occur for the injury caused by junior-priority ground water rights as shown above. As previously shown, the Director has "some" discretion in interpreting existing rules, but he does not have the discretion to invent an entirely new process -- especially when the legislature has enacted a specific methodology through the Conjunctive Management Rules for the replacement of water in a call.

(c) The Conjunctive Management Rules Provide a Comprehensive Framework in which to Determine if Mitigation is Legally Sufficient.

To safeguard the interests of the senior priority water rights, the Conjunctive Management Rules prescribe process and standards for evaluating mitigation (replacement water) plans to ensure any injury to the senior water rights will be prevented. *See* IDAPA 37.03.11.043(01)-(03) (Submission, Notice and Hearing, and Factors to be Considered). As a consequence, submitting signed lease(s) and supporting documentation may only be deemed an approved mitigation plan once the Director holds a hearing and evaluates the leases as provided in the Conjunctive Management Rules.

Conjunctive Management Rule 43.03 states that the Director in evaluating whether a proposed mitigation plan will prevent injury to senior rights may include, but is not limited to, fifteen factors as denoted below:

> a. Whether delivery, storage and use of water pursuant to the mitigation plan is in compliance with Idaho law.
>
> b. Whether the mitigation plan will provide replacement water, at the time and place required by the senior-priority water right, sufficient to offset the depletive effect of ground water withdrawal on the water available in the surface or ground water source at such time and place as necessary to satisfy the rights of diversion from the surface or ground water source. Consideration will be given to the history and seasonal availability of water for diversion so as not to require replacement water at times when the surface right historically has not received a full supply, such as during annual low-flow periods and extended drought periods.
>
> c. Whether the mitigation plan provides replacement water supplies or other appropriate compensation to the senior-priority water right when needed during a time of shortage even if the effect of pumping is spread over many years and will continue for years after pumping is curtailed. A mitigation plan may allow for multi-season accounting of ground water withdrawals and provide for replacement water to take advantage of variability in seasonal water supply. The mitigation plan must include contingency provisions to assure protection of the senior-priority right in the event the mitigation water source becomes unavailable.

d. Whether the mitigation plan proposes artificial recharge of an area of common ground water supply as a means of protecting ground water pumping levels, compensating senior-priority water rights, or providing aquifer storage for exchange or other purposes related to the mitigation plan.

e. Where a mitigation plan is based upon computer simulations and calculations, whether such plan uses generally accepted and appropriate engineering and hydrogeologic formulae for calculating the depletive effect of the ground water withdrawal.

f. Whether the mitigation plan uses generally accepted and appropriate values for aquifer characteristics such as transmissivity, specific yield, and other relevant factors.

g. Whether the mitigation plan reasonably calculates the consumptive use component of ground water diversion and use.

h. The reliability of the source of replacement water over the term in which it is proposed to be used under the mitigation plan.

i. Whether the mitigation plan proposes enlargement of the rate of diversion, seasonal quantity or time of diversion under any water right being proposed for use in the mitigation plan.

j. Whether the mitigation plan is consistent with the conservation of water resources, the public interest or injures other water rights, or would result in the diversion and use of ground water at a rate beyond the reasonably anticipated average rate of future natural recharge.

k. Whether the mitigation plan provides for monitoring and adjustment as necessary to protect senior-priority water rights from material injury.

l. Whether the plan provides for mitigation of the effects of pumping of existing wells and the effects of pumping of any new wells which may be proposed to take water from the areas of common ground water supply.

m. Whether the mitigation plan provides for future participation on an equitable basis by ground water pumpers who divert water under junior-priority rights but who do not initially participate in such mitigation plan.

n. A mitigation plan may propose division of the area of common ground water supply into zones or segments for the purpose of consideration of local impacts, timing of depletions, and replacement supplies.

o. Whether the petitioners and respondents have entered into an agreement on an acceptable mitigation plan even though such plan may not otherwise be fully in compliance with these provisions.

IDAPA 37.03.11.43.03 (a)-(o).

Without evaluating the mitigation plan and its proposed replacement water supplies against these factors or, alternatively, without information as to why certain factor(s) are not applicable and what factors were considered instead, there is no certainty that injury to senior water rights will be prevented as required by Conjunctive Management Rule 43.03. Furthermore, without this kind of analysis, there is also no certainty that there will not be an "unnecessary delay" in providing a replacement supply. *See AFRD #2*, 143 Idaho at 874 (the Supreme Court confirmed that the drafters of Idaho's Constitution intended timely response to delivery call with no unnecessary delay in delivery of water). As a result, the Director must approve any mitigation plans pursuant to and as envisioned by the Conjunctive Management Rules. Further, until the submitted mitigation plan and replacement supplies are evaluated under the provisions of the Conjunctive Management Rules, the replacement plans cannot be deemed effective.

(c) The Conjunctive Management Rules Require the Timely Replacement of Water.

The Idaho Supreme Court stated that a timely response is necessary when water is necessary to respond to a delivery call. *AFRD #2*, 143 Idaho at 874. The Conjunctive Management Rules provide when the Director assesses a mitigation plan, he should determine whether the mitigation plan provides for replacement water at the "time and place" required by the senior-priority water right. IDAPA § 37.03.11.43.03(b).

The ground water users' replacement plans provide little, if any, certainty as to "time and place" when wet water will be delivered to senior priority water rights. Their replacement plan states that:

> [T]he Ground Water Districts propose as their 2007 Joint Replacement Water Plan to mitigate any and all material injury by guaranteeing and underwriting Twin Falls Canal Company's

> irrigation season supply up to 1,009,100 acre feet based upon 5/8 inch per acre headgate delivery. Should the combined sum of the storage allocated to Twin Falls Cana Company and the natural flow delivered to Twin Falls Canal Company during the irrigation season be less than 1,009,100 acre-feet..., **the Ground Water Districts will pay the Water District 1 Rental Pool charges or otherwise supply sufficient water to eliminate the resulting water debt** of Twin Falls Canal Company on the books of Water District 1.

Exhibit 4502, Ground Water Districts' Joint Replacement Water Plan for 2007 at 6 (emphasis added).

The Ground Water Users placed eight limitations on "appropriate" accounting methods the Water Master shall apply against Twin Falls Canal Company's irrigation season supply. *Id.* The ground water user's replacement plan also states that the "Twin Falls Canal Company's calculated water debt will be replaced by the Ground Water Districts **during or at the end of the irrigation season** from storage water procured by the Ground Water Districts." *Id.* at 8 (emphasis added). Moreover, the ground water users' require the Water Master to first apply acquired leased water to satisfy the North Snake Ground Water District and Magic Valley Ground Water Districts Joint Replacement Water Plan for 2007 for Water District 130, and *then* any remaining amount can be dedicated to the proposed 2007 Joint Replacement Water Plan. *Id.* Finally, if that is not enough, the ground water users state that any water released past Milner Dam for hydro-power generation or ESA purposes should count against Twin Falls Canal Company's irrigation supply, as well as *any* carryover storage remaining on the books in the final accounting in 2007 for Twin Falls Canal Company. *Id.*

It is fair to say in regards to the submitted Replacement Plan of the Ground Water Users that they do not really believe that they have an obligation to provide wet water. If they do, their obligation only arises *after* the Joint Replacement Plan for 2007 for Water

District 130 is met, and *after* the water accounting books are closed at the end of the year – January or February of the next calendar year. The ground water users then may either pay the Water District 1 Rental Pool charges of water that Twin Falls Canal Company had to purchase for its supply or utilize water that they might have secured that could be transferred into Twin Falls storage account after the irrigation season is completed. It seems by requiring these actions as conditions precedent, the ground water users hope that their obligation for mitigation water will not materialize. But what these actions actually do is shift the burden and the risk of a less than full water supply from the ground water users to the Twin Falls Canal Company.

It is also hard to understand why the ground water users' aver that Twin Falls Canal Company should be held responsible for flows past Milner since the Nez Perce Agreement and the rainbow (colorful) chart from the Upper Snake River Basin was negotiated and approved by as a settlement of the State of Idaho, the United States Congress, the Nez Perce Tribe, plus numerous other entities. *Dreher, H. Tr. Vol. II, pp. 290-291, LL. 19-9; Gregg, H. Tr. Vol. VI, pp. 1229, LL. 20-24.* It is similarly disingenuous to hold the Twin Falls Canal Company responsible for hydro-power flows past Milner that either Reclamation has authority to deliver under contract to Idaho Power or Idaho Power has authority to purchase from the rental pool and supply to its facilities below Milner as provided by Idaho law. *Dreher, H. Tr. Vol. II, p. 329, LL. 18-21; p. 330, LL. 13-16.* By the ground water users requiring any flows past Milner as negating in kind their obligation to the Twin Falls Canal Company, it reinforces again that they, as junior water users, are looking for anyway they can to avoid supplying wet water in time and place to satisfy Twin Fall Canal Company's water needs.

The ground water users point to everyone and everything else as being the problem, yet they take no responsibility to assume any of the risk or burden from the impacts of their own ground water pumping.

3. STORAGE SUPPLIES, INCLUDING RENTALS, ARE SUBJECT TO FEDERAL CONTRACTS AND/OR RENTAL POOL RULES.

(a) Storage Rentals or Leases Must be Transferred in Real Time.

The federal government owns and operates the storage reservoirs and certain associated facilities. *H. Tr. Vol. V, p. 917-198, LL. 23-18.* Reclamation has entered into spaceholder contracts for storage water under specific terms and conditions as required by Federal law. *Gregg, Tr. Vol. VI, p. 1195-1196, LL. 15-8. & H. Tr. Vol. VI, p. 1238, L.4.* Two of these conditions, among others, require the irrigation entity to repay a certain amount of the reservoir's construction costs and a certain yearly operation and maintenance costs. *Gregg, Tr. Vol. VI, p. 1195-1196, LL. 15-8.*

Consistent with the terms of the contracts, and as provided by Idaho law, a spaceholder may place part of its storage water in the rental pool for irrigation or power uses or to allow it to be purchase as flow augmentation by Reclamation as authorized by the Nez Perce Agreement's rainbow (colorful) chart. *Gregg, H. Tr. Vol. VI, pp. 1197-1199, LL. 23-16; pp. 1230-1231, LL. 22-1; Swank, H. Tr. Vol. V, pp. 19-23.* The Committee of Nine, in conjunction with the Water Master, and the Bureau of Reclamation has developed rental pool rules that describe how rentals of storage water will occur. *Swank, H. Tr. Vol. V, p. 927, 7-14.*

The rental pool rules describe how the rentals may occur and if carryover is allowed. *Swank, H. T. Vol. V, p. 927, LL. 1-5.* Storage water may be placed in the rental pool and carried in a spaceholder's account until purchased, at which time it must be

transferred to the purchaser's account. *Gregg, H. Tr. Vol. VI, p. 1199, LL. 8-12.* There is no provision, however, and it is inconsistent with federal contracts and federal law, to purchase storage water and have it rest in some non-existent unassigned account or in limbo. *Gregg, Tr. Vol. VI, p. 1198-1199, LL. 25-12.*

Any such accounting would be unauthorized under federal law since the storage water must be in an account with an entity that has a contract with Reclamation. *Gregg, Tr. Vol. VI, p. 1198, LL. 4-8.* As a consequence, all rentals or leases of storage water have to occur consistent with the rental bank rules and the accounting must reflect the account that the water moves into upon purchase. *Gregg, Tr. Vol. VI, p. 1199, LL. 8-15.*

CONCLUSION

Reclamation asserts the Director's limitation on carryover is unreasonable since there is an increased risk of future water shortages in the Upper Snake River Basin from long-term droughts, increased variability of flows, and latent ground water pumping impacts yet to accrue. These risks, until recent times, have been managed by the development of carryover storage that allows all kinds of users' access to storage water in times of drought through the rental pool.

The Director's new paradigm of reasonable carryover, however, makes himself the sole authority on how to balance risk of future water shortages amongst junior and senior water users. When balancing this risk, the Director does so by, among other things, placing a limitation on carryover storage. The effective result of this limitation is that it actually reduces the amount of carryover that will be available to *all* rental pool users in times of drought.

The Director abused his discretion when he failed to follow the provisions of the Department's Conjunctive Management Rules since they provide for multiple years of carryover and since the rules also provide for a mitigation plan with an accompanying comprehensive evaluation of whether the replacement of water is legally sufficient. The Director has some discretion as provided by the Supreme Court's decision in *AFRD # 2* to interpret these rules, but since the Conjunctive Management Rules were promulgated and confirmed by the Idaho Legislature, he is without authority to either entirely disregard the provisions or to create a new process outside the one the rules provide.

Further, under the current Director's paradigm, the timing of mitigation that is to be supplied to satisfy reasonable carryover is illusory. Under the Director's order, reasonable carryover shortages will never need to be repaid since the obligation is merged into the following year's injury determination, or it is carried over as a rolling debit/credit to the following year; or it is cancelled because the reservoir space fills. But the Conjunctive Management Rules require that real water be provided in time and place as needed by the injured senior water user – it cannot be illusory as shown by the Supreme Court's decision in *AFRD # 2.*.

If replacement occurs in lieu of curtailment, there must be transferred real water (typically, storage water through the rental pool) in time and place as provided by the Conjunctive Management Rules and consistent with the Rental Pool Rules that also require the transfer of rental pool water upon purchase. It is the purchaser who decides when to utilize the rental water. Since neither the storage accounting program (consistent with contractual provisions) nor the rental pool rules allow storage space, once assigned, to become unassigned and to reside in a "limbo land" of water, the Director's has a legal

obligation as shown by the Conjunctive Management Rules and as provided by the Rental Pool Rules to assign the replacement water as soon as possible after he receives it.

DATED this 26th day of February 2008

KATHLEEN MARION CARR

CERTIFICATE OF SERVICE

The undersigned certifies that on the 26th day of February 2008, a true and correct copy of **Reclamation's Post Hearing Response** was served on the following person(s) as shown below:

Via Hand-Delivery

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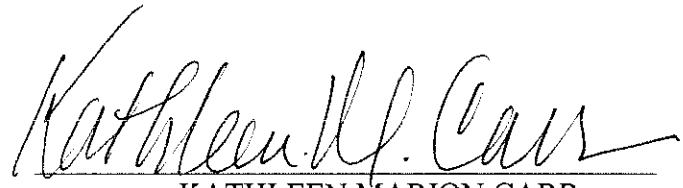

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