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IN RE: NON-BINDING ARBITRATION PURSUANT TO THE FINAL  
SETTLEMENT STIPULATION, *KANSAS v. NEBRASKA and COLORADO*,  
NO. 126 COLORADO

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BEFORE MARTHA O. PAGEL, ARBITRATOR

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Nebraska Crediting Dispute

ARBITRATOR'S FINAL DECISION

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October 7, 2010

## I. History of the Case

This non-binding arbitration arises pursuant to Section VII (Dispute Resolution) of the Final Settlement Stipulation (“FSS”), executed on December 15, 2002 by the states of Colorado, Kansas and Nebraska (the “States”), and approved by the United States Supreme Court. *Kansas v. Nebraska & Colorado*, 538 U.S. 720, 123 S. Ct. 1898 (2003). The FSS was negotiated among the States to resolve litigation then pending before the Supreme Court relating to ground water use under the Republican River Compact (“Compact.”)

Section VII.A.1 of the FSS provides that any matter relating to Compact administration, including administration and enforcement of the FSS, in which a State has an “Actual Interest” (as defined in Section II of the FSS), shall first be submitted to the Republican River Compact Administration (“RRCA”). Section VII.A.7 provides that if such a dispute cannot be resolved by the RRCA, and the State raising the dispute desires to proceed, the dispute shall be submitted to non-binding arbitration unless otherwise agreed to by the States with an Actual Interest.

The subject matter of the arbitration is the “Nebraska Crediting Issue” presented for arbitration by State of Nebraska, pursuant to the FSS process. The issue relates to an adjustment Nebraska submits must be made to Compact accounting to properly acknowledge damages that may be paid for Compact violations. Although no damages have as yet been awarded or paid by any State under the FSS, Nebraska requested the RRCA approve a specific methodology for crediting damages payments in the process for determining Compact compliance under the FSS. The Nebraska Crediting Issue was joined with a separate issue, referred to as the Colorado Compact Compliance Pipeline Issue (“CCP Issue”) for purposes of joint arbitration hearings. However, the States have requested the Arbitrator issue separate final decisions for the two issues under review.

This is the second arbitration proceeding convened pursuant to the FSS. The first was conducted by Arbitrator Karl J. Dreher and was completed in mid-2009. Following briefing and hearings, Mr. Dreher issued two decisions: The Arbitrator’s Final Decision on Legal Issues, dated January 22, 2009, and the Arbitrator’s Final Decision, dated June 30, 2009.

On March 22-24, 2010, the three States issued a Joint Notice of Arbitration and entered into a contract for this second arbitration proceeding with the selected Arbitrator, Martha O. Pagel.

On April 8, 2010, the Arbitrator issued a Scheduling and Procedural Order and revised Time Frame Designation for the joint arbitration proceedings, including a timeline for submission of legal motions and briefs, responsive briefs, reply briefs and oral argument on the motions.

On April 9, 2010, the States completed execution of an Arbitration Agreement regarding the CCP Issue (“CCP Arbitration Agreement”), and on May 5, 2010, the States completed execution of a similar Arbitration Agreement for the Nebraska Crediting Issue Dispute (“The Crediting Issue Arbitration Agreement”; collectively, the “Arbitration Agreements”).

Pursuant to the Arbitration Agreements and Scheduling and Procedural Order, the States filed motions on legal issues, along with opening, responsive and reply briefs. Kansas filed

Motions to Dismiss both the CCP Issue and the Nebraska Crediting Issue in their entirety; Colorado filed a Motion to Dismiss additional issues raised by Nebraska and Kansas in connection with the CCP Issue and a Motion to Strike certain testimony submitted by Kansas in support of its Motion to Dismiss the CCP Issue.

On May 5, 2010, the States presented oral argument on the legal issues in a joint hearing on the CCP Issue and Nebraska Crediting Issue held in Portland, Oregon. At the outset of the hearing, Colorado and Nebraska (the “Stipulating States”) submitted a Joint Notice of Stipulation to the Arbitrator and the State of Kansas confirming that that the Stipulating States had fully resolved all issues in the Arbitration as between them pursuant to the terms of the Stipulation. Accordingly, no further action was taken on Colorado’s Motion to Dismiss with respect to the Nebraska issues.

On May 17, 2010, the Arbitrator issued a Joint Decision on Legal Issues with rulings on motions in both the CCP Issue and Nebraska Crediting Issue, denying the motions to dismiss and finding that both issues were properly the subject of arbitration under the FSS.

On July 12-14, the Arbitrator conducted a joint evidentiary hearing in Kansas City, Kansas, at which the States addressed both the CCP Issue and the Nebraska Crediting issue.

At the trial, Nebraska presented the oral testimony and written report of one witness, Dr. James Schneider, along with four exhibits including Dr. Schneider’s expert report.

Kansas presented the oral testimony and written report of one expert witness, Mr. David L. Pope, along with six exhibits including Mr. Pope’s expert report.

This Decision includes the Arbitrator’s summary of key issues and evidence, findings of ultimate fact and conclusions of law, along with supporting analysis and recommendations as appropriate on the Nebraska Crediting Issue. A separate decision, issued this date, addresses the CCP Issue.

## **II. Nature of the Arbitration Proceeding**

The arbitration addresses a request by Nebraska for approval of a method whereby a payment of damages by Nebraska to Kansas for past Compact noncompliance in a given year would be recognized in future compliance tests. As described in further detail below, Nebraska first submitted the proposed crediting plan to the RRCA for approval (the “Crediting Proposal”, or “Proposal”). Kansas and Colorado voted to reject the Crediting Proposal and thereafter Nebraska initiated non-binding arbitration in accordance with the FSS procedures.

The FSS does not provide further explanation of the nature and scope of “non-binding arbitration.” However, based on the limited track record of prior experience with FSS arbitration, and the direction contained in the Arbitration Agreement entered into among the States, it appears the process has two key purposes: First, to provide findings of facts, analysis and conclusions that may inform further action by the States; and second, to provide for a neutral, third-party assessment, including recommendations, that may help promote resolution of the issues without further legal proceedings.

At trial, Nebraska presented evidence and legal argument to demonstrate the objectives of the Crediting Proposal and the manner in which the proposal would be implemented. Nebraska now asks the Arbitrator to acknowledge the need for the credit to avoid “double recovery” under the system of rolling averages used by the FSS to compute Compact compliance and to recommend approval of the methodology presented by Nebraska to resolve the current dispute. Nebraska’s Post Hearing Brief on the Nebraska Crediting Issue (“Neb. Post-Trial Brief”) at 16.

Kansas presented evidence and legal argument relating to alleged deficiencies in the Crediting Proposal, asserting the proposal is contrary to the requirements of the FSS and constitutes an attempt by Nebraska to substitute money for water for purposes of future compliance. Kansas also argues the Crediting Proposal is incomplete and premature and would encourage noncompliance. Kansas’ Post-Trial Brief, Colorado Compact Compliance Pipeline Dispute/ Nebraska Crediting Issue (“Kan. Post-Trial Brief”) at 38.

In rendering a decision on facts and the law, the Arbitrator is guided by the same standards and rules of law applicable to a court. In recommending a proposed remedy, the Arbitrator offers the opinion of a third-party neutral, applying general background and experience in the field of water law and administration to the issues under review.

### **III. Applicable Standards/Rules of Law**

Section IV.D. of the FSS establishes the requirement of a five-year “running average” (sometimes referred to as “rolling average”) for computing Compact compliance. That section provides, in pertinent part:

“Except as described in Subsection V.B., all Compact accounting shall be done on a five-year running average in accordance with the provisions of the RRCA Accounting Procedures....”

FSS Section IV.D.

Subsection V.B. of the FSS describes alternative procedures to be applied for purposes of “Water Short Year (“WSY”) Administration.” Subsection V.B.2.(e) provides for use of a two-year running average during drought periods meeting the identification criteria established for WYSA determination in Subsection V.B.1. (Nebraska refers to the five-year running averages typically applied under the FSS as “Normal Year Administration” (“NYA”) for purposes of distinguishing the five-year tracking from the two-year process used during WSYA periods).

The term “running average” is not further defined in the FSS, however detailed procedures for computing and tracking the five-year and two-year (WYSA) running averages are addressed in the RRCA Accounting Procedures and related compliance tables. *See* FSS, Appendix C, III.

Under the terms of the Compact, decisions by the RRCA, as the administering body of the Compact, must be unanimous and consistent with the provisions of the Compact. (Compact, Article IX.) Approval by the RRCA is expressly required for any proposed changes to the RRCA Accounting Procedures. FSS, Section I.E.

In making such decisions, as members of the RRCA, the States are subject to general rules of contract law, including an implied duty of good faith and fair dealing. The U.S. Supreme Court has determined the terms of an interstate compact are not subject to these same general rules because of the unique character of a compact as not only an agreement among the affected states, but also as a federal statute enacted by Congress. As such, the Court has determined, its cannot be altered by courts. *See Alabama v. North Carolina*, 130 S. Ct. 2295, 2212-2213, 176 L. Ed. 2d 1070 (2010). In contrast, the FSS is a stipulated consent decree, separately negotiated by the three States and not enacted into federal or state law. Accordingly, actions by the individual States under authority of the FSS would appear to be subject to contract law. *See, e.g. United States v. ITT Cont'l Baking Co.*, 420 U.S. 223, 236 (1975). Since the concept of an “augmentation plan” is addressed only in the FSS, and not in the underlying Compact, decisions relating to approval or rejection of a proposed augmentation plan are subject to the law of contracts.

When a contract includes provisions for approval by the parties, general principles of contract law require that the parties must exercise discretion reasonably, and may not do so arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.” *Behara v. Baxter Health Care*, 956 F.2d 1436, 1443 (7<sup>th</sup> Cir. 1992).

#### **IV. Summary of Decision**

The Nebraska Crediting Proposal seeks an adjustment in the procedures used to determine Compact compliance to reflect payments of monetary damages from one State to another. Specifically, the proposal is intended to address a problem of “double recovery” that Nebraska asserts will occur unless the requested crediting process is used. The potential for double recovery arises because of the use of running averages and multiple-year compliance periods under FSS accounting procedures. Nebraska asks the Arbitrator to find that the Crediting Proposal is necessary to address the problem of double recovery. Kansas opposes the Crediting Proposal on the basis of five issues identified during the arbitration process.

As set forth below, the Arbitrator concludes Nebraska has not demonstrated that the Crediting Plan is necessary to avoid the asserted double recovery of damages, and that Kansas has raised reasonable objections to the Crediting Proposal with respect to three of the five issues presented.

The decision is in favor of the State of Kansas and against the State of Nebraska with recommendations for further action by the States.

#### **V. Opinion**

##### **A. Overview of Crediting Proposal**

The Crediting Proposal is described in Nebraska’s Exhibit 4, labeled for the record as “Nebraska’s Crediting Issue RRCA Submittals.” The primary submittal in Exhibit 4 is a letter from Nebraska’s RRCA Commissioner Brian P. Dunnigan to the RRCA Commissioners for Kansas and Colorado, dated June 15, 2009. N. Neb. Exh. 4 at 4-7.

As described in the June 15, 2009, letter, “The issue concerns *an adjustment* Nebraska submits must be made to Compact accounting to properly acknowledge damages paid for past Compact violations.” *Id.* at 4 (Emphasis added.) The letter states an intention that the proposed Crediting procedures will be limited to three specific compliance periods under the FSS:

- 2005 – 2006 Two-year average above Guide Rock;
- 2006 – 2007 Two-year average above Guide Rock; and
- 2003 – 2007 Five-year average for the Republican River Basin.

*Id.* at 5.

However, the letter also includes a footnote stating, “Whatever rule is established in this process presumably will apply equally to the State of Colorado for any damage payments associated with any Colorado overuse.”

In a section defining the concept of the Crediting Proposal, the letter explains:

“Nebraska submits that when a State is found to be in violation of the Compact and pays damages based on that violation, that State should receive a credit in the Compact accounting to reflect the payment made. Specifically, *the Compact accounting should be adjusted* by reducing the annual CBCU [Computed Beneficial Consumptive Use as determined under the FSS] calculation for the year in which payment is made by that amount of water of which the downstream state was deprived according to the official RRCA accounting spreadsheets.”

*Id.* at 5 (Emphasis added.)

Thus, if Nebraska were to pay damages to Kansas for a shortage under 2005-2006 WSY Administration, under the Crediting Proposal Nebraska’s 2006 annual CBCU would be reduced on a prospective basis by the volume of water on which the damage payment was based. *Id.* In other words, it is expected that damages would be paid on an amount of water reflecting the average amount of overuse for the compliance period in question (in this example, 2005-2006), rather than on the actual amount of overuse in any given year. The Proposal assumes Nebraska would be given “a full credit” for payment of an award based on the averaged amount of overuse. *Id.* at 5-6.

The letter includes a table to further illustrate the concept. *Id.* at 6. The table shows that by applying the Crediting Proposal, Nebraska will be in compliance in years that would otherwise have shown overuse. Nebraska maintains the crediting plan will thereby avoid “double recovery” for the same violation that would occur as a result of the two-year and five-year running averages used in the FSS. *Id.*

A follow-up letter dated July 29 to the Kansas and Colorado Commissioners amends the proposal to include a revised timeline for action by the RRCA, but does not make any substantive changes to the plan. N. Neb. Exh. 4 at 9-11. A proposed resolution submitted for

consideration by the RRCA includes recitals describing the background of the issue but no additional details about the Crediting Proposal, resolving that the RRCA approve and adopt “the proposal set forth in Nebraska’s June 15, 2009 letter,” a copy of which was attached to and incorporated into the resolution. *Id.* at 13. The Crediting Proposal submitted by Nebraska does not include specific changes to the RRCA Accounting Procedures or Tables.

At its meeting on August 12, 2009, the RRCA did not adopt the resolution, and thereafter Nebraska invoked non-binding arbitration, by letter dated August 28, 2009. *Id.* at 1-2.

## **B. Disputed Issues**

At the arbitration trial on July 14, 2010, and in its Post-Trial Brief, Nebraska presented evidence and argument in support of its contention that approval of the Crediting Proposal is necessary to ensure that a State does not pay twice for the same overuse. Tr. Vol. 3, p. 523-550 (Schneider); N. Neb. Exh. 2 (Schneider Report); Neb. Post-Trial Brief at 15-16. A payment for damages by Nebraska would therefore be recognized in future Compact compliance periods that included an overlap with the year in which payment was made. Kansas responds that the Crediting Proposal would substitute money for water, contrary to the requirements of the Compact and FSS Decree; that the Proposal would encourage future Compact violations and deprive Kansas water users of water due to them under the Compact; and that the Crediting Proposal is incomplete and premature. Kan. Post-Trial Brief at 31-38.

The disputed issues are addressed below:

### **1. Whether the Crediting Proposal is necessary to avoid double recovery.**

#### **Ultimate Findings and Conclusions**

Implementation of the Crediting Proposal is not necessary to avoid a double recovery for damages that may be paid by Nebraska to compensate Kansas for past violations of the Compact. The system of evaluating “running averages” for multiple-year compliance periods established under the FSS establishes a framework for identifying discrete, separate violations for which damages or other remedies may be sought. It is not necessary or appropriate to provide a “credit” in the FSS accounting procedures for determining compliance in subsequent accounting periods. To do so would undercut the purposes of the Compact and the complex, but agreed-upon structure of running averages used to determine compliance.

#### **Summary of Issue and Key Evidence**

Nebraska contends the Crediting Proposal is necessary to avoid a double recovery of damages that may be paid to Kansas as compensation for past violations of the Compact. Nebraska asserts the Crediting Issue arose from a demand by Kansas for money damages due to Nebraska’s alleged violation of the two-year 2005-06 Water Short Year (“WSY”) compliance period. Neb. Post-Trial Brief at 1. Upon payment of money damages for that violation, Nebraska argues that Kansas would be made whole in the eyes of the law, and should not be entitled to further recovery for the same violation. *Id.* However, Nebraska argues the potential for multiple recoveries for the same violation exists as a result of the two-year and five-year running averages used to determine Compact compliance under the FSS. *Id.* Nebraska asks the Arbitrator to

acknowledge the inherent potential for double recovery associated with the system of multiple-year compliance periods, and to accept Nebraska's proposal as an appropriate means to address the circumstances specified therein. *Id.*

The primary basis for Nebraska's argument is the legal principle of "election of remedies." Nebraska contends that Kansas must make an election of remedies with respect to any given violation, which may take the form of money or water, but not both. *Id.* at 2. The argument is based on the established legal principle of "election of remedies", under which an aggrieved party must elect from among its available remedies and cannot receive a double recovery. *Id.* at 6. Nebraska explains that the requirement for election of remedies means "a plaintiff who is injured by reason of a defendant's behavior is, for the most part entitled to be made whole, not to be enriched." *Id.* (citing 22 Am. Jur. 2d Damages § 28 (2010)). The object of compensatory damages is to make the injured party whole for losses actually suffered; not to create a windfall for the plaintiff. *Id.*

Kansas asserts that Nebraska's proposal would allow money to be substituted for water, a concept that Kansas argues would be contrary to established law relating to interstate compacts. Kan. Post-Trial Brief at 33. Kansas relies on a case involving a dispute over the Pecos River in which the Supreme Court ruled that money damages or water could be awarded for past compact violations, while at the same time entering a decree requiring future delivery of water as required under the compact. *Id.* (citing *Texas v. New Mexico*, 482 U.S. 124, 129-133 (1987)). Kansas contends the Court clearly distinguishes between remedies for past violations in damages of either water or money on the one hand, and future compliance on the other.

Kansas also rejects the premise that payment of damages, without the crediting proposed by Nebraska would lead to the potential for double recovery for a single violation. Kansas contends that the system of running averages and multiple-year compliance periods established in the FSS creates the potential for multiple violations. Kansas asserts compliance must occur in each multiple-year compliance period set forth in the FSS (either the five-year period for "normal" years, or the two-year period for WSY Administration). N. Kan. Exh. 2 at 10 (Pope Report). For each such compliance period, overuse in one year must be offset by underuse in another year or years in the same compliance period. If that balancing does not occur within the specified compliance period, the State is determined to be in violation – a single violation, according to Kansas, based on the averaging of actual use data for each year of the compliance period. *Id.*

Kansas explains that if damages were paid for overuse in the two-year compliance period of 2005 and 2006, there would be no double recovery for this period because Kansas would not have received both water and money for this compliance period. *Id.* at 12. The fact that actual use data for 2006 is carried forward for purposes of determining compliance within another compliance period does not result in double recovery if damages are ultimately awarded for the second distinct violation in a subsequent compliance period. N. Neb. Exh. 4 at 4.

### **Analysis and Recommendations**

The determination of whether a crediting plan is a necessary and appropriate mechanism for addressing the potential for money damages is driven by an understanding of the purposes



and objectives of the compliance provisions of the FSS. Nebraska's closing argument provides a useful framework to highlight the fundamental differences between Nebraska's and Kansas' interpretation of those provisions.

Nebraska begins its analysis by noting that the Crediting Issue arose from a demand by Kansas for money damages due to Nebraska's alleged violation of the 2005-2006 WSY compliance period. Upon receipt of money damages for that violation, Nebraska concludes that Kansas "would be made whole in the eyes of the law." Thereafter, in Nebraska's analysis, it would be unfair and result in a double recovery or windfall to Kansas if Nebraska did not receive a water credit equal to the amount of non-compliance on which the damages were assessed. Nebraska asserts that unless it is awarded credit for any damage payment it might make, Kansas could recover for a violation of the 2006-07 compliance period even though the average value used to determine compliance for that period was derived using the same 2006 annual value on which Kansas' initial recovery was made. Nebraska argues such "multiple recoveries" are inequitable and legally impermissible. Kansas must elect its remedy for any given violation, which may take the form of money or water (but not both). Nebraska proposes the Crediting plan to solve this "problem."

Kansas views the situation quite differently. In fact, Kansas sees no "problem" given the compliance structure contained in the FSS. Kansas describes the FSS structure as creating a distinction between Compact "enforcement" and Compact "administration." The concept of Compact enforcement applies to allow for the payment of damages to account for noncompliance at the end of each accounting period, reflecting the history of underuse and overuse during each year of the period in question. The result is a single "wrong" for which compensation may be awarded. Each subsequent accounting period gives rise to the potential for another "wrong."

The conclusions drawn by Kansas are more persuasive.

Nebraska's analysis relies on an assertion that the legal principles of election of remedies require Kansas to pick water or money for any given compliance period; but that it may not receive both. The analysis is flawed because it fails to recognize the broad legal and equitable powers granted to the U.S. Supreme Court in deciding interstate compact disputes. As demonstrated in the *Texas v. Mexico* case, the Court could award both monetary damages to compensate for past violations in failing to deliver water, as well as injunctive relief requiring future water deliveries. This would result in Kansas receiving both water and money as a result of the same violation.

In the *Texas v. New Mexico* case, a Special Master appointed by the Supreme Court found that New Mexico, the upstream State, had failed to provide water that it was obligated to deliver at the Texas state line under the Compact, with a shortfall of 340,100 acre-feet over a 33 year period. 482 U.S. at 127. The Special Master recommended that New Mexico be ordered not only to perform its ongoing obligation under the Compact, but to make up the accumulated shortfall by delivering 34,010 acre-feet of water each year for 10 years, with a penalty in kind – "water interest" – for any bad-faith failure to deliver these amounts. *Id.* at 127-128. New Mexico filed an exception to the proposed remedy. *Id.* at 128.

The Supreme Court confirmed that it has the power to provide both legal and equitable remedies for past breaches of a compact. *Id.* The Court explained that an equitable remedy, such as the specific performance, “rests entirely in judicial discretion, to be exercised...according to the settled principles of equity” including an analysis of “the relative benefits and burdens that the parties may enjoy or suffer as compared with a legal remedy in damages.” *Id.* at 131.

The *Texas v. New Mexico* case clearly establishes the Court’s discretion to order either equitable or legal relief (water or money damages), but it does not limit the Court’s ability to order both; nor does the legal principle of election of remedies. Instead, election of remedies would generally apply to prevent a plaintiff from electing two *inconsistent* remedies. For example, in the case of contract disputes, remedies based on affirming the contract (such as damages, specific performance and reformation) are inconsistent with remedies based on disaffirming the agreement (such as rescission and restitution). The election of one remedy excludes the other, because a party may not both affirm and rescind a contract at the same time. *See, e.g. Equitable Trust Co. v. Connecticut Brass & Mfg. Corp.*, 10 F.2d 913, 915 (1926)(citing *United States v. Oregon Lumber Co.*, 260 U.S. 290 (1922) and *Robb v. Vos*, 155 U.S. 13, 41-42 (1894)). However, the remedy of specific performance is not necessarily inconsistent with damages, because both remedies are predicated on an affirmation of the contract. Accordingly, the Supreme Court could award equitable relief that included both a requirement for monetary damages, and an order requiring future compliance as argued by Kansas.

Nebraska next argues that the doctrine of election of remedies applies to prevent a double recovery for a single wrong. This is a correct statement of the general rule. *See Pa. Nat’l Mut. Cas. Ins. Co. v. City of Pine Bluff*, 354 F.3d 945, 950-951 (8th Cir. 2004). In this situation, however, there is an important question of fact as to what constitutes a “single wrong.” Kansas provides a logical and persuasive argument that Compact compliance must be demonstrated in each multiple-year compliance period set forth in the FSS (either the five-year period for “normal” years, or the two-year period for WSYA). N. Kan. Exh. 2 at 10 (Pope Report). The mere fact that the accounting provisions include a carry-over of compliance *data* from one year to the next does not constitute a carry-over of the *violation* from one compliance period to the next.

The Nebraska proposal calls for payment of damages to offset the net amount of noncompliance within a specified compliance period, rather than to offset any single year of overuse. The amount is therefore an *average* of two or five years – reflecting different amounts of actual overuse in each year. The averages for subsequent multiple-year compliance periods are derived from the table entries showing actual noncompliance in each year of that subsequent period. The determination and potential payment of damages for one compliance period is therefore separate from the evaluation of compliance in a subsequent compliance period, even though the determination involves the use of data carried-over from one period to another.

Finally, as addressed in Issue 6, below, the determination of whether the Crediting Proposal is needed to prevent a double recovery cannot be fully evaluated until there is an actual award of damages. As a result, it is recommended that further action on the Crediting Proposal be delayed until the Supreme Court takes action on the Petition filed by Kansas in May of this year.

**2. Whether the Crediting Proposal is contrary to the Compact and FSS by allowing substitution of money for water.**

**Ultimate Findings and Conclusions**

The Crediting Proposal would be contrary to the Compact and FSS by substituting money for water during the years in which a credit would be substituted for actual water use to determine Compact compliance.

**Summary of Issue and Key Evidence**

Kansas asserts the Compact allocates water, not money. As a result, it would be inconsistent with the Compact, and the subsequently adopted compliance procedures contained in the FSS, to allow a payment of money damages for a past violation to substitute for water deliveries required to show compliance in future compliance periods. Kan. Post-Trial Brief at 33-35.

Kansas explains that under the FSS, for each multiple-year compliance period, overuse in one year must be offset by underuse in another year or years in the same compliance period. N. Kan. Exh. 2 at 11 (Pope Report). Instead of requiring water users to underuse in future years to counterbalance overuse in prior years within the same period, Kansas argues the Nebraska crediting concept allows overuse to be counterbalanced by a payment of damages. *Id.* at 13. Kansas asserts this is directly contrary to the Compact.

Nebraska contends the proposed Crediting plan merely avoids a double recovery for a prior violation. *See* Issue 1, above. Further, Nebraska notes that it is within Kansas' exclusive power to elect to seek money damages in the first place. Neb. Post-Trial Brief at 10-11. Once the election is made and the damages are paid, Kansas is not also entitled to receive additional water under the FSS for the same violation. *Id.*

**Analysis and Recommendations**

The question of whether the Crediting Proposal would be contrary to the Compact by allowing Nebraska to substitute money for water is very similar to the question considered in Issue 1 above, relating to the asserted "double recovery." As a bottom line, the answer to both questions hinges on whether the payment of damages is viewed as compensation for a single past violation.

Nebraska holds steadfastly to the notion that the carry-forward provisions of the multiple-year compliance periods prescribed in the FSS will result in double payment for a single violation. Nebraska argues that because the Crediting Issue arises from an aggrieved State's demand for monetary compensation to address past noncompliance, the aggrieved State controls the extent to which the Crediting issue applies, and can therefore limit its application. The implication is that by pursuing a demand for damages, the aggrieved State loses its ability to also demand future compliance from the standpoint of Compact administration and water management. Under Kansas' view of the FSS requirement, the argument would be reversed: The multiple-year accounting procedures provide the legal opportunity – if not the practical means – for the violating State to avoid the future violation by managing water during the

subsequent compliance period. The record shows Nebraska was unable to do that during the three periods in question; accordingly, there is a price to pay.

On this issue, Kansas makes a more persuasive argument consistent with the objectives of the Compact and the structural framework of the FSS.

If the Crediting Proposal were adopted, the effect would be to substitute money paid for a past violation for required compliance in future accounting periods. This would be contrary to the Compact and FSS requirements and would result in a windfall to Nebraska, allowing accountability for potential future violations to be erased with a single payment for a past violation. Each five-year or two-year compliance period calculated under the FSS procedures creates the potential for a new Compact violation. Each Compact violation is subject to enforcement through a request for the payment of damages or other relief.

**3. Whether the Crediting Proposal is contrary to the Compact and FSS by encouraging future compact violations.**

**Ultimate Findings of Fact/Conclusions of Law**

Implementation of the Crediting Proposal would not encourage future Compact violations.

**Summary of Issue and Key Evidence**

Kansas asserts the Crediting Proposal is a “hedge” against Nebraska’s future Compact noncompliance. Kan. Post-Trial Brief at 35. Kansas argues the concept would allow an upstream State to weigh the economic costs of noncompliance against the burden of compliance on its water users and therefore would allow Nebraska to plan ahead for the payment of damages as an alternative to Compact compliance. *Id.*; N. Kan. Exh. 2 at 12 (Pope Report).

Nebraska responds that it does not seek to institutionalize a “pay to play” compliance method. Neb. Post-Trial Brief at 13. Nebraska argues Kansas’ assertion ignores the genesis of the Crediting Issue and erroneously assumes Nebraska will be incentivized by the provision of a credit to violate the Compact in the future in lieu of compliance. *Id.* at 14. In support of its argument, Nebraska notes that the Crediting Proposal was developed only in response to a demand by Kansas for damages. Tr. Vol. 3, p. 533, ln. 19 – p. 534, ln. 11 (Schneider). Nebraska provides evidence that it is currently in compliance with the Compact and has been in compliance since 2008, Tr. Vol. 3, p. 574, ln. 12-17 (Schneider) and that Nebraska continues to make efforts to comply with the Compact, including leasing surface water even during wet years, Tr. Vol. 3, p. 574, ln. 7 – p. 574, ln. 8 (Schneider). Nebraska states this is true even though it would have been much cheaper to pay damages. Tr. Vol. 3, p. 575, ln. 9-12 (Schneider).

Nebraska also confirms that the Crediting Proposal currently at issue is intended to address only three specific periods of past noncompliance: the two-year periods of 2005-2006 and 2006-2007, and the five-year period from 2003-2007. N. Neb. Exh. 1 at 2-3 (Schneider Report); N. Neb. Exh. 4 at 5; Neb. Post-Trial Brief at 3. Kansas observes that the intended time frame for applicability of the Proposal has been less than clear, finding inconsistencies in various documents and comments included in the record. *See* N. Kan. Exh. 2 at 6 (Pope

Report)(Nebraska proposal notes that it presumes the process will apply equally to any damage payments associated with any Colorado overuse); N. Kan. Exh. 2 at 6-7 (Pope Report) (damages for non-compliance would be recognized in future non-compliance tests).

Finally, Nebraska notes the Supreme Court has previously rejected the argument that payment of damages may create a disincentive for future water compact compliance in the *Texas v. New Mexico* dispute:

“It might also be said that awarding only a sum of money would permit New Mexico to ignore its obligation to deliver water as long as it is willing to suffer the financial penalty. But in light of the authority to order remedying shortfalls to be made up in kind, with whatever additional sanction might be thought necessary for deliberate failure to perform, that concern is not substantial in our view.”

*Texas v. New Mexico*, 482 U.S. at 132.

#### **Analysis and Recommendations**

Potential concerns about institutionalizing a “pay to play” compliance method would be greater if the Crediting Proposal were intended as a general policy for future compliance. Nebraska represents that the Crediting Proposal is intended to be limited to three specific compliance periods of apparent past violations. Although the record includes statements that can reasonably be viewed as ambiguous or equivocal on this issue, it is reasonable to rely on Nebraska’s stated intention to limit the Crediting Proposal to the three identified compliance periods. With such a limitation in place, the potential for crediting to become a factor in future water management decisions is eliminated.

Nebraska’s demonstrated compliance in recent years provides further evidence of its stated commitment to comply with Compact requirements for water deliveries in the future, and rejection of the “pay to play” argument is also consistent with the U.S. Supreme Court’s determination in the *Texas v. New Mexico* decision that the concern should not be viewed as substantial in light of the Court’s authority to order appropriate remedies for any deliberate failure to perform.

Given these considerations, it is unlikely the Crediting Proposal would lead to future Compact violations; however, if Nebraska continues to seek approval of the Proposal, Nebraska should clarify the Proposal to expressly and unequivocally describe the intended timeframe limits.

- 4. Whether the Crediting Proposal is contrary to the Compact and FSS by depriving Kansas water users of water due them under the Compact.**

#### **Ultimate Findings of Fact/Conclusions of Law**

The Crediting Proposal would not deprive Kansas of water due to its users in the future if the plan were implemented only for the three compliance periods identified by Nebraska.

### **Summary of Issue and Key Evidence**

In its Post-Trial Brief, Kansas asserts the use of the crediting concept in future periods would have a detrimental effect on Kansas water administration, arguing the practical effect of the Crediting Proposal is that water that should have been available to Kansas will not be available and the most Kansas will have in lieu of water is a claim against Nebraska for damages. Kan. Post-Trial Brief at 35-36.

In his written report, Mr. Pope addressed the basis of this argument, noting the FSS and Decree provide considerable flexibility and a benefit to each State that is upstream from another State through the rolling multiple-year compliance periods. In contrast, multiple-year allocations provide less protection to any State located downstream because more water can be used in any given year upstream, thereby resulting in less water downstream. N. Kan. Exh. 2 at 10 (Pope Report). Mr. Pope's report also includes a description of the purposes and potential benefits to States afforded by the multiple-year compliance system and the use of rolling averages. *Id.* at 10-11. He concludes the Crediting Proposal would undermine the integrity of the States' jointly developed accounting system and the results for other compliance periods. The result would be to allow more use by Nebraska by eliminating one or more years of overuse from multiple-year accounting periods, to the detriment of downstream users in Kansas. *Id.* Attachment 1 to the Pope Report provides three tables demonstrating the potential harm through reduced compliance obligations if the Crediting Proposal is used. *Id.* at Attachment 1.

Nebraska did not directly respond to this issue in the rebuttal report of its own expert, Dr. Schneider, or through direct examination at the trial. Similarly, the Crediting Proposal materials focus on avoiding a perceived harm to Nebraska, rather than on responding to an asserted harm to Kansas water users. However, Nebraska indirectly addresses the issue raised by Kansas by confirming its intention that the Crediting Proposal is intended to apply only retrospectively to the three identified compliance periods. *See* N. Neb. Exh. 4 at 5; Tr. Vol. 3, p. 560, ln. 5 – p. 562, ln. 23 (Schneider).

### **Analysis and Recommendations**

This issue raised by Kansas stems from concerns very similar to those addressed in Issue 3, above, regarding future implications of the Crediting Proposal. The concerns would be well founded if the Nebraska proposal were implemented as a general policy, applicable to future water management under the Compact. If applied to future multiple-year compliance periods, the Crediting Proposal would likely result in less water being available to Kansas water users. With respect to future water deliveries, however, the potential harm can be avoided by limiting the Crediting Proposal to the three specific past compliance periods listed in Nebraska's June 15, 2009 letter, incorporated as part of its proposal to the RRCA. If the proposed Crediting does not extend past the end of the 2003-2007 compliance period, any harm to Kansas water users resulting from altered compliance requirements will have already occurred and will not extend into the future. Accordingly, the Crediting Proposal should be revised to clearly reflect the stated intention regarding limited applicability.

## 5. Whether the Crediting Proposal is Incomplete

### Findings and Conclusions:

The Crediting Proposal is incomplete, and should not be approved in the form presented to the RRCA.

### Summary of Issue and Key Evidence

Kansas asserts the Crediting Proposal is incomplete with respect to its treatment of key components of the plan. Kan. Post-Trial Brief at 36. Specifically, Kansas argues the Proposal is unclear about the intended temporal limits (limiting to three identified periods of past non-compliance); that Nebraska has not provided wording for an implementing rule; that Nebraska has not explained if crediting will be applied at a sub-basin level if the Proposal is applied to Colorado or how the crediting concept affects unallocated water flexibility under Subsection IV.B of the FSS; and that the Crediting Proposal would be unenforceable because Nebraska has proposed no changes to the RRCA Accounting Procedures that Kansas asserts would be necessary to apply the crediting plan. *Id.* at 37.

With respect to the question of temporal limits, Nebraska explained its intention to limit applicability of the Crediting Proposal to the three specified periods of non-compliance listed in the June 15, 2009 letter to RRCA Members. N. Neb. Exh. 4 at 5; Tr. Vol. 3, p. 560, ln. 5 – p. 562, ln. 23 (Schneider). Nebraska maintains no changes are required in the RRCA Accounting Procedures to implement the Crediting Proposal, stating that it seeks only to include an additional, parallel table that reflects the reality of any damage payment made by a non-compliant state. N. Neb. Exh. 1 at 2 (Schneider Report). Nebraska asserts Kansas' concern that the Crediting Issue might apply differently with regard to a payment made by another State, like Colorado, in a future enforcement action, is irrelevant because Nebraska is not proposing to apply the Crediting Proposal to such other fact situations. Neb. Post-Trial Brief at 12-13.

### Analysis and Recommendations

The most obvious deficiency in the Crediting Proposal is the failure of Nebraska to propose specific changes in the RRCA Accounting Procedures and tables that will be needed to implement the adjustment required under the crediting concept. Nebraska states plainly that it seeks to include an “additional, parallel table” for accounting purposes; however, there is no mechanism for doing so under the FSS and related RRCA Accounting Procedures without proposing specific changes for adoption by the RRCA. The addition of a parallel table is, in fact, a change in the RRCA Accounting Procedures that requires approval under the FSS.

As previously addressed in connection with Issues 3 and 4, above, the Crediting Proposal also lacks clarity regarding the intended applicability. The wording of the June 15, 2009 letter submitted to the RRCA is ambiguous. The body of the letter implies an intention that the Crediting Proposal would be limited to the three designated multi-year compliance periods; but footnote “1” to the letter casts doubt on that intention. Similarly, the testimony of Dr. Schnieder on cross examination was less than definitive in responding to questions about whether the Crediting Plan would, in fact, be limited to just the three compliance periods listed in the June 15 letter.

The lack of clarity regarding the timeframe for applicability of the Proposal extends to the issue of whether the Crediting Proposal would apply to noncompliance in other states, and to the related tests for sub-basin compliance or flexibility in the use of unallocated water, as provided under the FSS. In its closing argument, Nebraska confirms its intention that the Proposal does not apply to such other fact situations or compliance periods; however the Crediting Proposal should more clearly describe the specific parameters determining how and when it will apply.

The Crediting Proposal, in its current form, is incomplete because it does not include a recommendation for specific changes needed in the RRCA Accounting Procedures to accommodate use of an additional table to reflect crediting changes and because it does not clearly state the intended limitations on its future use and applicability.

#### **6. Whether the Crediting Proposal is Premature.**

##### **Findings and Conclusions:**

Because of the broad scope of review allowed under the FSS arbitration provisions, the Crediting Proposal is not premature for consideration in this forum.

##### **Summary of Issue and Key Evidence**

The premise of Nebraska's Crediting Proposal is an asserted need to avoid double recovery in the event damages are awarded and paid to Kansas for alleged past violations by Nebraska. Kansas asserts the proposal is premature as no such damages have been awarded or paid by any State under the Compact. Kansas argues that Nebraska's concern regarding avoidance of double recovery, if that is an issue at all in some future court action, is a defense that requires both factual and legal bases to assert and prove. Kan. Post-Trial Brief at 37. Kansas contends that a court of competent jurisdiction is capable of ruling on such issues and that Nebraska will have the opportunity to plead its case at that time. *Id.*

Nebraska does not directly address this issue in the evidence or argument presented at trial, but the issue was previously briefed in response to motions on legal issues presented at an earlier stage of the arbitration proceeding.

Subsequent to issuance of the Arbitrator's decision on legal issues, but prior to the trial, Kansas filed a petition for relief before the United States Supreme Court. N. Kan. Exh. 5. The petition alleges Kansas has no adequate remedy at law to enforce its rights under the Compact and asks the Supreme Court to exercise its authority to order equitable relief in considering a number of proposed remedies, including that Nebraska:

- “4. Be ordered to pay over the amount of its profits or the amount of Kansas' losses resulting from Nebraska's violation, whichever is greater, together with pre-and post-judgment interest;
5. Be ordered to pay preset sanctions in the event of future violations in an amount sufficient to remove the incentive for Nebraska to violate the Decree;



6. Be ordered to reduce groundwater pumping, or to take other specific and equivalent actions, by a date certain, sufficient to ensure Decree compliance in the future; [and]...
7. Be ordered to undertake such alternative or additional actions as the Court may deem just and equitable to the States under the circumstances....”

*Id* at 12.

### **Analysis and Recommendations**

In asserting that the Crediting Proposal is “premature” Kansas raises the legal question of whether the crediting proposal is “ripe” for arbitration or subsequent judicial action by the Supreme Court because, to date, there has been no award of damages. This question of law issue was considered earlier in the arbitration proceedings. *See* Arbitrator’s Joint Decision on Legal Issues (May 17, 2010) at 9-12. The Arbitrator concluded that the issue was not premature for purposes of an arbitration proceeding because of the broad scope of review afforded under the FSS. *Id.* However, the prior decision acknowledged substantial legal authority for the argument that the ripeness doctrine is designed to prevent the courts from taking action prematurely on contingent future events that may not occur as anticipated, or may not occur at all. *Id.* at 10.

The filing by Kansas of a Petition with the U.S. Supreme Court prompts a second look at the issue of “ripeness” to determine whether the change of facts – filing of the Petition – affects the outcome of the prior decision on the issue of whether the Crediting Proposal is premature. However, the decision remains unchanged. Under rules of law applicable to the Court, the Crediting Proposal seems clearly to be premature. Although a petition is now pending before the Court, there has been no determination by the Supreme Court regarding the potential for an award of money damages, monetary sanctions, or other equitable relief. Accordingly, there is still no specific basis upon which to evaluate whether the specific concepts embodied in the Crediting Proposal are reasonable and necessary.

If presented to a Court, the Crediting Proposal would most likely be determined to be premature or not “ripe” for judicial review because it requires evaluation of a proposal that, at present is merely speculative. Within the framework of this non-binding Arbitration, these legal rules do not apply in the same way, and the Proposal must be given due consideration.

### **VI. Final Conclusions and Recommendations**

As further described in the findings and conclusions for Issues 1 – 5 above, the methodology of the Crediting Proposal cannot be recommended for approval, as requested by Nebraska. The Arbitrator does not find that the proposed crediting plan is necessary to avoid a double recovery. At the same time, it is reasonable that Nebraska would raise the issue in an attempt to reach agreement with the other States, in advance, as to how a potential award of damages should be treated under the FSS. Nebraska legitimately notes that no other alternative approach has been offered. Although there is no mandate under the Compact or FSS that such an agreement be reached, clearly, this is something the States *could* agree to address through a stipulated agreement or changes in Accounting Procedures.

Toward that end, the Arbitrator offers the following final conclusions and recommendations:

1. The system of rolling averages and multiple-year compliance periods used for determining Compact compliance was negotiated and agreed to by the States and should be the foundation in any plan for addressing the payment of damages.
2. The system offers each State the flexibility, and responsibility, to first attempt to manage water use in a way that balances overuse and underuse of water during any given compliance period.
3. The system reflects an underlying intent to ensure an equitable distribution of water to each State. In that regard, the States have implicitly placed a higher value on the receipt of water in compliance with Compact Allocations than on the receipt of damages for Compact violations.
4. The system does not preclude the payment of damages for noncompliance during any two-year or five-year compliance period. The completion of each period triggers a new determination of compliance and gives rise to a separate potential violation, or "wrong" that would be the basis for a claim seeking damages or other relief.
5. As a result, the system of rolling averages and multiple-year compliance periods does not create the need for a crediting concept such as has been proposed by Nebraska. Although the legal arguments relating to election of remedies appear persuasive at first blush, they do not bear up under a more detailed analysis of the complex and unique structure for determining Allocations and Computed Consumptive Beneficial Use on an annual basis while relying on rolling averages over the two- or five-year periods to determine compliance with Compact obligations.
6. The Crediting Proposal would result in an artificial manipulation of the Tables required for use under the FSS Accounting Procedures. The result would be to deprive Kansas of the ability to seek and obtain full compensation for any subsequent period of noncompliance relying on the manipulated Tables. Conversely, Nebraska would receive on-going, multiple-year benefits from the one-time payment of damages.
7. The fact that Nebraska is now on track for future compliance with its Compact Allocations provides an opportunity to focus on the three periods of past violation that Nebraska indicates were intended to be addressed under the Crediting Proposal. Because the extent of these past violations is known and complete at this point in time, the States have an opportunity to consider a one-time negotiated settlement of monetary damages as an alternative to the Crediting Proposal.

Dated: October 7, 2010

  
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Martha O. Pagel  
Arbitrator

CERTIFICATE OF SERVICE

I hereby certify that on the 7th day of October, 2010, I served a copy of the foregoing **ARBITRATOR'S FINAL DECISION** by e-mail and by sending a true and correct copy thereof by overnight courier on:

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