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March 12, 2008

By E-Mail and First Class Mail

Special Master Kristin L. Myles
Munger, Tolles & Olson LLP
560 Mission Street
27th Floor
San Francisco, CA 94015

Re: *South Carolina v. North Carolina*, No. 138, Original: South Carolina's First Progress Report

Dear Special Master Myles,

Pursuant to our initial conference call on February 6, 2008, and in advance of our upcoming conference call scheduled for March 14, 2008, we respectfully submit South Carolina's first progress report in the above-styled matter.

The parties conferred by telephone on March 3, 2008 and again on March 11 to address a range of issues designed to make the case proceed efficiently. In particular, we addressed a process for developing a Case Management Plan ("CMP") and identifying more precisely the legal and factual issues in the case. South Carolina is also in the process of preparing a map of the Catawba River Basin in accordance with the Special Master's request.

1. The parties are in agreement as to a general approach for bifurcating the case and the attendant discovery. In particular, the parties have agreed that phased discovery of this matter would be appropriate. During the first phase, discovery would be limited to the issue of whether South Carolina can make out a threshold showing of harm attributable to North Carolina's overuse of the Catawba River. The parties would submit cross-motions for summary judgment on that issue and conduct a hearing before the Special Master. It is unclear at this time whether the parties would need to present live witnesses at such a hearing or would present the case on a paper record. Assuming South Carolina makes the requisite showing of harm, the second phase

would be addressed to the appropriate remedial apportionment. Discovery and litigation would then commence focusing on those issues.

Further, the parties have exchanged Case Management Plans ("CMPs") familiar to them from prior original cases in this Court and have agreed to consult further on the precise terms to be used in a CMP for this case. South Carolina has agreed to circulate an initial draft CMP and to solicit comment from North Carolina. The aim is to provide the Special Master with a CMP on which both sides agree.

2. As a means of identifying more particularly the factual and legal issues in the case, North Carolina offered a set of six "preliminary questions," to which South Carolina agreed to provide preliminary responses. South Carolina's responses are necessarily tentative at this point, and are provided without purporting to be exhaustive and subject to change as warranted by discovery or otherwise:

Question 1: Are South Carolina's allegations of harm limited to interbasin transfers ("IBTs") approved by North Carolina?

Response 1: South Carolina's allegations of harm are not limited to IBTs. Although IBTs comprise a significant and readily identifiable portion of the harm South Carolina alleges, South Carolina cannot, without first gaining a more complete picture of the consumptive uses of the Catawba River, say that IBTs are the only consumptive uses that contribute to North Carolina's overuse of the Catawba River and hence harm South Carolina.

Question 2: Are South Carolina's allegations of harm limited to periods of drought only?

Response 2: South Carolina's complaint is targeted to periods when flows of the Catawba are inadequate for existing and currently contemplated uses in South Carolina. Accordingly, South Carolina agrees that, in formulating a decree, the Court may wish to set an appropriate threshold flow above which an equitable apportionment decree would not be triggered. But such periods of inadequate flows are not limited to times when either State has publicly declared "drought" conditions. Indeed, adopting – without inquiry – a definition of "drought" that has been formulated for the purpose of determining when to provide public notice of a water shortage, would be arbitrary at this early stage of the litigation.

Question 3: Do South Carolina's allegations of harms relate to the entire Catawba/Wateree River basin in South Carolina or only a limited portion of it (e.g., Lake Wateree and upstream)?

Response 3: South Carolina is further assessing its position with respect to this question at this time and will respond in due course to North Carolina.

Question 4: To what extent does South Carolina allege it would be harmed if the Federal Energy Regulatory Commission were to adopt the Comprehensive Relicensing Agreement

("CRA") for the Catawba-Wateree Hydroelectric project and impose flows consistent with those set out in the CRA?

Response 4: South Carolina believes that Question 4 is misdirected. This case is significantly broader in scope than the FERC proceedings. First, and fundamentally, the FERC does not control North Carolina's consumptive uses of water. As South Carolina noted in its Reply Brief In Support of Its Motion for Leave to File Complaint (at 5) – and as one of North Carolina's own participants in the Duke re-licensing proceedings has acknowledged – the CRA affects only how Duke Energy uses the water in the river, and does not control other users or stakeholders in the re-licensing process. *See id.* at 4-5. Indeed, the CRA itself (at § 39.9) provides that water rights are "[u]naffected"; that is, the CRA "does not release, deny, grant or affirm any property right, license or privilege in any waters or any right of use in any waters." Second, South Carolina does not concede that it is bound by the CRA, because the South Carolina agency authorized by law to represent the State in matters involving interbasin transfers, the Board of the Department of Health and Environmental Control ("DHEC"), has not consented to the CRA. *See* South Carolina's Reply in Support of Mot. for Leave to File Complaint at 8 (citing S.C. Code §§ 49-21-10, 49-21-80).

South Carolina does not dispute that the FERC proceedings, including implementation of the CRA, may have an appreciable effect on the flow of water into South Carolina and hence on this case. But South Carolina does not view one proceeding as preemptive of the other; indeed, the FERC proceedings may well be influenced significantly by the proceedings in this case. The focus of this case is on North Carolina's consumptive uses on the Catawba, and the harms those uses have caused (and continue to cause) in South Carolina.

Question 5: Does South Carolina support the flows set forth in the CRA, including as modified by the Low Inflow Protocol ("LIP") during periods of drought, or, is South Carolina seeking 1100 cubic feet per second at all times including during drought periods?

Response 5: Much of South Carolina's response to Question 4 applies equally to Question 5 and will not be repeated here. The LIP ultimately governs Duke's conduct, and South Carolina's position as to what may be appropriate conduct for Duke Energy under certain flow conditions does not necessarily bear on what is appropriate for North Carolina. Nor does the LIP render North Carolina's upstream conduct irrelevant. Under the terms of the LIP, when less water flows into the Duke system, Duke is allowed to release less water into South Carolina. *See id.* at 6. Thus, even if the LIP is implemented, North Carolina's excessive consumption will still cause less water to flow into South Carolina.

Question 6: Do South Carolina's allegations of harm relate to future as well as existing uses?

Response 6: South Carolina's complaint is based on harm to existing water uses in South Carolina and to those uses reasonably contemplated by current plans that would be subject to discovery in this litigation. An appropriate remedial decree presumably would take into account future uses in accordance with the precedents of this Court.

Respectfully submitted,

David C. Frederick

cc: Christopher Browning
Robert Cook