

ATTACHMENT B

Memorandum of Understanding between
the Navajo Nation and the City of Gallup
Concerning Water Supplies for the Navajo-
Gallup Water Supply Project (October 2007)

**MEMORANDUM
OF
UNDERSTANDING
BETWEEN THE NAVAJO NATION
AND
THE CITY OF GALLUP
CONCERNING WATER SUPPLIES FOR THE
NAVAJO-GALLUP WATER SUPPLY PROJECT**

PREAMBLE:

In 1971, Congress, through Public Law 92-199, authorized feasibility studies to provide a reliable and sustainable municipal water supply system that would serve the eastern portion of the Navajo Indian Reservation and the City of Gallup.

In April of 1998, the Navajo Nation and the City of Gallup agreed that the Navajo Nation and the City of Gallup have severe water quality and water quantity problems, and stated their intent to cooperate on the planning and development of the Navajo Gallup Water Supply Project (NGWSP or the Project) to serve the eastern portion of the Navajo Indian Reservation and the City of Gallup (City).

In December of 2000, the Northwest New Mexico Council of Governments completed a feasibility level study of the City's transmission and storage facilities needed to convey NGWSP water through the City and to the Navajo communities of Breadsprings, Chichiltah, Church Rock, Iyanbito, Mariano Lake, Pinedale, Red Rock, and Manuelito Chapters, which surround the City. These facilities are referred to as the Gallup/Rural Navajo Regional Water System (Gallup Regional System or System). Some of these System facilities are currently under construction utilizing a combination of State Water Trust Board funds, Indian Health Service funds, and other funds. The new facilities constructed as part of the Regional System are projected to have the capacity to provide up to an additional 5,000 acre-feet per year for the City and approximately 5,000 acre-feet per year for the Navajo communities. The initial water supply for this additional capacity is ground water. When the NGWSP delivers San Juan River water to the System, the water supply will be primarily surface water.

In November of 2001 the City of Gallup, Navajo Tribal Utility Authority (NTUA) and Navajo Area Indian Health Service entered into an agreement as part of the planning for the Gallup Regional System. In this agreement the City under certain terms and conditions will supply water to some 27 Navajo homes outside the City boundaries. Waterlines to these Navajo homes have been constructed.

In March of 2002 the Navajo Nation, through Resolution RCMA-16-02, selected the preferred alternative of the NGWSP that is contemplated in the San Juan River settlement between the Nation and the State. This alternative includes 7,500 acre-feet per year of capacity for the City, 1,200 acre-feet per year of capacity for the Jicarilla Apache Nation, and 29,000 acre-feet per year of capacity for the Navajo Nation in New Mexico and Arizona. Among other components, this alternative includes the San Juan Lateral along Highway 491 serving Beclaibito, Cudei, Hogback, Nenahnezad, San Juan, Shiprock, Upper Fruitland, Naschitti, Newcomb, Sanostee, Sheep Springs, Tohatchi, Twin Lakes, and Two Grey Hills Chapters of the Navajo Nation, and the Cutter Lateral serving Burnham, Huerfano, Nageezi, Counselor, Pueblo Pintado, Ojo Encino, Whitehorse Lake, and Torreon Chapters of the Navajo Nation and the Jicarilla Apache Nation.

In May of 2003, the City held a Town Hall on Water where approximately eighty members of the public, including officials of the Navajo Nation, discussed water issues facing the City and the Navajo Nation. On June 24, 2003, the Gallup City Council passed resolution R2003-11 adopting the recommendations of

the Town Hall, which endorsed the NGWSP and called upon the City leadership to work cooperatively with the Navajo Nation to advance the interest and prospects of the Project.

Since 2003, the Navajo Nation, the Navajo Area Indian Health Service, the Navajo Tribal Utility Authority, the United States Bureau of Reclamation, the United States Bureau of Indian Affairs, the City, and the Northwest New Mexico Council of Governments, working together through the NGWSP Steering Committee, received approximately \$5,000,000 in funding from the State of New Mexico for the design and construction of the Gallup Regional System, and approximately \$17,000,000 for the Cutter Regional System.

In April 2005, the Navajo Nation and the State of New Mexico executed a Settlement Agreement to settle the Navajo Nation's water rights claims within the San Juan River basin in New Mexico. The settlement will guarantee to the Navajo Nation San Juan River depletion rights of 325,670 acre-feet per year, including 20,780 for Navajo uses by the NGWSP in New Mexico. The Nation will have the right to lease its San Juan River settlement water. The Settlement Agreement requires congressional legislation to ratify the settlement and to authorize the construction of the NGWSP, specifically the Project configuration selected by the Navajo Nation in 1998.

In April 2007, Senators Bingaman and Domenici introduced settlement legislation S. 1171 -- the Northwestern New Mexico Rural Water Projects Act to ratify the settlement and to authorize the construction of the NGWSP. Similar legislation was introduced by Congressman Tom Udall as H.R. 1970.

The specific details of the authorizing legislation describing the terms and conditions for the City and Jicarilla Apache Nation to participate in the NGWSP have not been finalized. These terms and conditions will be developed as Congress considers S. 1171 and H.R. 1970. These terms and conditions include the determination of the repayment costs for the NGWSP, including the Cutter Lateral, and the determination of the extent of federal participation in the construction of the NGWSP. The outcome of these determinations may impact the City's and the Jicarilla Apache Nation's position as participants in the NGWSP and may effect the negotiation of the water supply agreements.

In March 2007, the Bureau of Reclamation released the Draft Environmental Impact Statement and Planning Report for the NGWSP (DEIS). The cost estimate for the NGWSP included in the DEIS was approximately \$720 million based on 2004 construction indices. The Bureau of Reclamation is revising those estimates to reflect 2007 costs, and the ultimate cost of the Project could be significantly greater. The Federal Administration does not support S. 1171 and H.R. 1970 because of the costs of the Project, and the legislation faces opposition in Congress for similar reasons. The legislation is not likely to succeed unless it can be demonstrated that if built, there will be water for all the Project uses.

Presently, the City of Gallup does not have a source of water for use in the Project. This MOU is intended to describe a mechanism or process that can be utilized to secure the City of Gallup a source of water for the Project.

TERMS AND COMMITMENTS:

1. Exchange of Groundwater. Construction of the Gallup Regional System helps communities surrounding Gallup receive water prior to the construction of the NGWSP. The source of water prior to construction of NGSWP is groundwater. In order to provide a supply of water for the Navajo Nation communities to be served by the Gallup Regional System, the Navajo Nation and the City of Gallup agree to exchange up to 500 acre-feet per year of groundwater per year. This exchange will give the Navajo Nation and the City of Gallup greater flexibility to meet the region's water needs prior to

construction of the NGWSP. For example, water from City wells may provide supplies for delivery to the chapters south of or surrounding Gallup while water from Navajo wells may provide delivery to the north side of the City's delivery area. In order to facilitate this exchange:

a. The Navajo Nation and the City of Gallup will determine the conditions and rates for groundwater that will supply the Gallup Regional System prior to construction and completion of the NGWSP. The rates will reflect an equitable price to address NTUA and City delivery costs, the value to the Navajo Nation and to the City for the lost opportunity to use its respective groundwater for other purposes such as long-term drought protection, and a capital improvement component that the Navajo Nation and the City can invest in the NGWSP and related facilities at their discretion.

b. The City will pay NTUA for the receipt of some portion of the 500 acre-feet per year based on a "take or pay" fee structure based on the ability of NTUA to deliver such water. NTUA will pay for the receipt of some portion of the 500 acre-feet per year based on a "pay as you go" fee structure.

c. At the end of the exchange period, if either the Navajo Nation or the City has exceeded its aggregate, the exceeding party will offset the difference by supplying water from the NGWSP to the non-exceeding party.

d. The exchange period will end when the San Juan Lateral is operational unless both parties mutually extend it.

2. City of Gallup Surface Water Supply for the First 25 Years of NGWSP. The City of Gallup does not have water rights to the San Juan River, nor has it secured a source of surface water for use in the Project. The Navajo Nation is committed to working with the City of Gallup to find a surface water supply for the project. During the first 25 years of the Project, it is likely that the source of water for the City of Gallup will be out of the Navajo Reservoir Supply Contract to be executed between the Navajo Nation and the Secretary of the Interior as part of the Navajo Nation's San Juan River settlement. The Navajo Nation's Navajo Reservoir Supply Contract is anticipated to be 22,654 acre-feet per year for NGWSP uses in New Mexico. The City's water uses in the NGWSP are not to exceed 7,500 acre-feet per year. It is anticipated that the Navajo Nation could lease up to 7,500 acre-feet per year for the first 25 years of the Project out of its Navajo Reservoir Supply Contract without diminishing any anticipated Navajo demands. Accordingly:

a. The Navajo Nation and the City of Gallup agree to negotiate a subcontract of water from the Navajo Nation's Navajo Reservoir Supply Contract for a water supply not to exceed 7,500 acre-feet per year for a term of 25 years following completion of the Project.

b. The terms of the subcontract can not be fully ascertained at present, but the City of Gallup agrees that it will pay the Navajo Nation an equitable price for the supply of water based on such factors as:

i. the fair market value of the water;

ii. the Navajo Nation's water fee structure established by the Navajo Nation Water Code;

- iii. the OM&R costs incurred by NTUA to operate the NGWSP and the need to defray these costs in order to provide affordable water utilities to the Navajo people;
 - iv. the water fees paid by other municipalities similarly situated;
 - v. the overall cost of water delivered to the City of Gallup, taking into account the costs of water delivery;
 - vi. incentives to encourage the acquisition and/or development of alternate water supplies by the City of Gallup; and
 - vii. consideration of the value provided by the City of Gallup by its conveyance of water to Navajo communities through the Gallup Regional System.
- c. The terms of the subcontract should be negotiated prior to commencement of construction of the NGWSP. In order to ensure that a subcontract will be in place prior to construction of the Project, the Navajo Nation and the City of Gallup agree to have in place prior to Congressional authorization of the project, a set of Principles of Understanding that will set forth the basic parameters of the subcontract, including a dispute resolution process in the event that the terms and conditions of the subcontract cannot be agreed upon.
- d. The City of Gallup intends to acquire alternate sources of water as may be feasible in order to secure a permanent water supply.
- e. The Navajo Nation intends to use the proceeds from the subcontract for:
- i. Defraying the operation, maintenance, and replacement costs incurred by NTUA to operate the Project; and/or
 - ii. Building distribution systems from the Project facilities to Navajo homes and communities; and
- f. Nothing in any agreement between the Navajo Nation and the City of Gallup should foreclose the possibility that some or all of the 7,500 acre-feet of supply for the first 25 years of the Project could be provided by a subcontract between the Jicarilla Apache Nation and the City of Gallup or from some other source.

3. City of Gallup Surface Water Supply After the First 25 Years of NGWSP. In the event that the City of Gallup has not secured a permanent supply of surface water for some or all of the 7,500 acre-feet for its use in the Project, the City may still require a subcontract from the Navajo Reservoir water supply. Based on the projected Navajo water demands for NGWSP, the Navajo Nation may not be able to subcontract 7,500 acre-feet of supply after the first 25 years of the Project out of the 20,780 acre-feet of the Navajo Nation's Navajo Reservoir supply contract for NGWSP uses in New Mexico. Therefore, the Navajo Nation cannot at this time commit to a subcontract beyond 25 years, but will continue to work with the City of Gallup to find a surface water supply for the project.

4. Other Commitments.

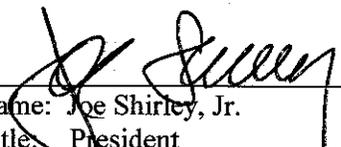
a. The Navajo Nation and the City of Gallup will work together to secure funds for the construction, extension or upgrade of new or existing conveyance and distribution systems for recipient communities that lack distribution systems or have inadequate distribution systems.

b. The Navajo Nation and the City of Gallup will continue to support the construction of the Cutter Lateral and associated infrastructure through in-kind resources, utilizing water proceeds and leveraging state and federal programmatic dollars.

c. In order to minimize the capital costs of the NGWSP, the Navajo Nation and the City of Gallup agree to provide access for all necessary rights-of-way without imposing fees, or to otherwise seek consideration for the use of their lands for the Project, on each other or on the United States. It is understood that the parties, on their own behalf or on behalf of their constituents, may request compensation for damages or disturbance of the surface uses arising out of the construction or operation of the Project.

Signatures:

NAVAJO NATION


Name: Joe Shirley, Jr.
Title: President
Date: OCT 30 2007

CITY OF GALLUP


Name: Harry Mendoza
Title: Mayor
Date:

