4TH CIVIL NO.

E051653

In the Court of Appeal

OF THE

State of California

FOURTH APPELLATE DISTRICT
DIVISION TWO

NON-AGRICULTURAL (OVERLYING) POOL COMMITTEE
and CALIFORNIA STEEL INDUSTRIES, INC.
Defendants and Appellants,

v.

CHINO BASIN MUNICIPAL WATER DISTRICT, et al.
Plaintiffs and Respondents.

APPEAL FROM THE SAN BERNARDINO SUPERIOR COURT
HONORABLE STANFORD E. REICHERT, JUDGE
Case No. RCVRS 51010

APPELLANT'S OPENING BRIEF

HOGAN LOVELLS US LLP
ALLEN W. HUBSCH, CAL. BAR NO. 136834
1999 AVENUE OF THE STARS, SUITE 1400
LOS ANGELES, CALIFORNIA 90067
TEL: 310-785-4600

Attorneys for Appellant NON-AGRICULTURAL (OVERLYING) POOL COMMITTEE

TO BE FILED IN THE COURT OF APPEAL COPY APP-008

COURT OF APPEAL, FOURTH APPELLATE DISTRICT, DIVISION TWO	Court of Appeal Case Number: E051653
ATTORNEY OR PARTY WITHOUT ATTORNEY (Name, State Bar number, and address): Allen W. Hubsch (Bar No. 136834) HOGAN LOVELLS US LLP 1999 Avenue of the Stars, 15th Floor Los Angeles, California 90067 TELEPHONE NO.: 310-7854600 FAX NO. (Optional): (310) 785-4601 E-MAIL ADDRESS (Optional): allen.hubsch@hoganlovells.com ATTORNEY FOR (Name): Non-Agricultural (Overlying) Pool Comm	Superior Court Case Number: RCVRS 51010 FOR COURT USE ONLY FILED SEP 7 2010 COURT OF APPEAL FOURTH DISTRICT
APPELLANT/PETITIONER: Non-Agricultural (Overlying) Pool Committee and California Steel Industries, Inc. RESPONDENT/REAL PARTY IN INTEREST: CITY OF CHINO, ET AL.,	

CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

(Check one): [X] INITIAL CERTIFICATE [ ] SUPPLEMENTAL CERTIFICATE

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1. This form is being submitted on behalf of the following party (*name*): Non-Agricultural (Overlying) Pool Com

2. a. [ ] There are no interested entities or persons that must be listed in this certificate under rule 8.208.
   b. [X] Interested entities or persons required to be listed under rule 8.208 are as follows:

Full name of interested entity or person	Nature of interest (*Explain*):
(1) Aqua Capital Management LP	Member of Pool Committee
(2) Auto Club Speedway	Member of Pool Committee
(3) California Steel Industries	Member of Pool Committee
(4) City of Ontario	Member of Pool Committee
(5) RRI Energy Etiwanda, Inc.	Member of Pool Committee

[ ] Continued on attachment 2.

The undersigned certifies that the above-listed persons or entities (corporations, partnerships, firms, or any other association, but not including government entities or their agencies) have either (1) an ownership interest of 10 percent or more in the party if it is an entity; or (2) a financial or other interest in the outcome of the proceeding that the justices should consider in determining whether to disqualify themselves, as defined in rule 8.208(e)(2).

Date: September 1, 2010

Allen W. Hubsch
(TYPE OR PRINT NAME)

▶ _____
(SIGNATURE OF PARTY OR ATTORNEY)

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CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

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STATE OF CALIFORNIA)
) ss.
COUNTY OF LOS ANGELES)

I am employed in the County of Los Angeles, State of California. I am over the age of eighteen and not a party to this action. My business address is Hogan Lovells US LLP, 1999 Avenue of the Stars, Suite 1400, Los Angeles, CA 90067.

On **September 7, 2010**, I caused the foregoing document described as:

CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

to be served on the interested parties in this action as follows:

[SEE ATTACHMENT]

[X] **BY MAIL.** I sealed said envelope and placed it for collection and mailing following ordinary business practices.

[ ] **BY HAND DELIVERY.** I caused such envelope to be delivered by hand to the offices of the addressee(s) following ordinary business practices.

[ ] **BY FACSIMILE.** I served such document via facsimile to the facsimile number as indicated above.

[ ] **BY E-MAIL.** I caused such document(s) to be served via e-mail.

[ ] **BY OVERNIGHT SERVICE.** I caused such document to be delivered by overnight mail to the offices of the addressee(s) by placing it for collection by UPS/Federal Express following ordinary business practices by my firm, to wit, that packages will either be picked up from my firm by UPS/Federal Express and/or delivered by my firm to the UPS/Federal Express office.

[X] **(State)** I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. **Executed on September 7, 2010,** at Los Angeles, California.

Kristen Echols
Print Name

Kristen Echols
Signature

PARTY AND ATTORNEY INFORMATION

Scott S. Slater, Esq. Michael T. Fife, Esq. Brownstein Hyatt Farber Schreck, LLP 2029 Century Park East, Suite 2100 Los Angeles, CA 90067 Telephone: (310) 500-4600 Facsimile: (310) 500-4602 *Attorneys for Chino Basin Watermaster, Respondant*	Steven G. Lee, Esq. Reid and Hellyer, LLP 3880 Lemon Street, Fifth Floor P.O. Box 1300 Riverside, CA 92502-1300 Telephone: (951) 682-1771 Facsimile: (951) 686-2415 *Attorneys for Agricultural Pool, Respondant*
John Schatz, Esq. Attorney at Law P.O. Box 7775 Laguna Niguel, CA 92607-7775 Telephone: (949) 683-0398 Facsimile: (949) 305-6865 *Attorneys for Appropriative Pool, Respondant*	Karin Dougan Vogel, Esq. Geoffrey K. Willis, Esq. Sheppard, Mullin, Richter & Hampton 501 West Broadway, Suite 1900 San Diego, CA 92101 *Attorneys for California Steel Industries, Inc., Movant and Appellant*

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I. INTRODUCTION

This appeal concerns whether a written contract (referred to herein as the "Peace II Option") is a purchase contract or an option, whether the notice of exercise required to be given under the Peace II Option was given and, if so, whether the notice was given in the manner required by the Peace II Option.

The underlying action is an adjudication of water rights in the Chino Basin. The judgment entered in 1978 (the "Judgment") established a Watermaster, an Advisory Committee, three Pools and three Pool Committees. The three Pools established by the Judgment are the Agricultural Pool, the Non-Agricultural Pool and the Appropriative Pool. Each Pool has its own Committee.

Under the Peace II Option, Watermaster, as agent for all members of the Appropriative Pool, held an option to purchase certain storage water (the "Pre-2007 Storage Water") from certain members of the Non-Agricultural Pool. Under the Peace II Option and the Judgment, Watermaster could only exercise the option by providing a written notice of intent to purchase by U.S. mail on or prior to December 21, 2009. Watermaster failed to provide such notice. When Watermaster's failure to provide notice was raised in January 2010, Watermaster retrospectively created a story about having given notice by alternative means in August 2009.

Because the Peace II Option was an option, Watermaster was required to strictly comply with the applicable notice requirements, and alternative means were not legally sufficient. Moreover, as a legal matter, notice, if any, provided by Watermaster was legally insufficient because it was (a) not final, (b) not clear and unambiguous; and (c) not actually

communicated to the persons entitled to receive it.

II. RELIEF SOUGHT IN THE TRIAL COURT

On March 16, 2010, the Non-Agricultural Pool filed a motion (the "Motion") in the trial court for a declaration that Watermaster did not provide the required written notice of intent to purchase. (I:1 AA 1-19.)

The Motion was made pursuant to Paragraph 31 of the Judgment, which provides that any party or any Pool Committee may, by a regularly noticed motion, apply to the trial court for review of any action taken by Watermaster. (Judgment, III:47 AA487:8-488:18.) Paragraph 31 further provides that the "question at issue" shall be reviewed de novo by the trial court, and that any findings or decision by Watermaster "shall not constitute presumptive or prima facie proof of any fact in issue". (Judgment, III:47 AA488:13-14.) In other words, in any action pursuant to Paragraph 31, no deference is afforded to Watermaster's actions, findings or decisions.

On June 18, 2010, the trial court denied the Motion in a 30-page ruling. (VI:93 AA1413-1449.) The court first found that the Peace II Option was not an option. (VI:93 AA1429:8-1431:3.) The trial court appeared to base its determination on use of the term "condition subsequent" in Paragraph H of the Peace II Option, but without discussion. Otherwise, the trial court did not appear to consider the Peace II Option substantively, but rather relied largely on the title of the contract.

The trial court found that legally sufficient notice was provided by virtue of participation in the August 27 meeting by an alternate member of

the Watermaster Board (Mr. Kevin Sage),[1] who was also an alternate representative of a single member of the Non-Agricultural Pool Committee that owned none of the Pre-2007 Storage Water, and had no economic interest in the matter. (VI:93 AA 1431:18-1433:25).[2]

The trial court also found that legally sufficient notice was provided pursuant to an e-mail (I:21 AA:111) that was circulated on August 21, 2009 that contained no reference to the Peace II Option, included no attachment, and merely stated that the agenda for the then-upcoming August 27 meeting of the Watermaster Board had been posted to Watermaster's website. (VI:93 AA1433:28-1435:14.)

In the trial court, Watermaster argued that the members of the Non-Agricultural Pool had an obligation to remind Watermaster to give the notice, and failed to do so. The trial court found the Non-Agricultural Pool's silence was not estoppel because (1) "there is no foundation for the court to conclude that all the members of the nonagricultural pool knew there was a notice of intent document in the agenda package for the August 27, 2009 board meeting" (VI:93 AA1438:25-28); and (2) other than Mr. Sage, "there is no basis to conclude any of the other nonagricultural pool

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[1] The trial court erroneously found that Mr. Bob Bowcock also attended the August 27 meeting, and voted in favor of approving the notice of intent to purchase. (VI:93 AA 1431:22-23). No party contended in the trial court that Mr. Bowcock attended the meeting, and the basis for the Court' finding on this subject is unknown. The minutes of the August 27 meeting correctly reflect that Mr. Bowcock did not attend the meeting. (I:13 AA67-68).

[2] The trial court also erroneously found that the minutes of the August 27 "were electronically distributed to interested parties" in addition to being maintained on the watermaster website. (VI:93 AA1431:24-1432:1.) None of the declarations or documents submitted into evidence support the

members actually received the notice of intent." (VI:93 AA1439:4-7.) In other words, the trial court found that notice was provided while simultaneously finding that not even one of the affected members of the Non-Agricultural Pool actually received it, and none even know it existed.

The Motion was decided entirely on the basis of the moving, opposition and reply papers. There was no evidentiary hearing. The testimony submitted consisted entirely of written declarations.

The Non-Agricultural Pool Committee timely appealed.

III. ORDER APPEALED FROM

A. The Trial Court Order Is Appealable

The Trial Court Order is appealable as an order made after entry of an appealable judgment. (Code of Civil Procedure § 904.1(a)(2).) The Judgment expressly preserves and facilitates all parties' right to appeal post-judgment orders, providing that any decision of the trial court in connection with a motion made pursuant to Paragraph 31 is "an appealable supplemental order." (Judgment, III:47 AA488:15-18.)

B. De Novo Standard of Review

All issues raised in this appeal are subject to de novo review. The appeal concerns the interpretation of a written contract, namely (a) whether the Peace II Option is a purchase contract or an option and (b) whether the notice given, if any, was legally sufficient.

"The interpretation of a written document is a question of law, not of fact," and thus is subject to de novo review." (*Edmond's of Fresno v. MacDonald Group, Ltd.* (1985) 171 Cal.App.3d 598, 603; *Welk v.*

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finding that the minutes were "electronically distributed" to the affected members of the Non-Agricultural Pool.

Fainbarg (1967) 255 Cal.App.2d 269, 272.) "The de novo standard of review also applies to mixed questions of law and fact when legal issues predominate." (*Harustak v. Wilkins* (2000) 84 Cal.App.4th 208, 212 (and cases cited therein).)

Moreover, when extrinsic evidence relating to interpretation of a contract consists entirely of written declarations, appellate review of law and fact involving the contract is de novo, even where the evidence conflicts. (*Id.* at 213; *Marcus & Millichap Real Estate Inv. Brokerage Co. v. Hock Investment Co.* (1998) 68 Cal.App.4th 83, 89; *Mayhew v. Benninghoff* (1997) 53 Cal.App.4th 1365, 1369; *Patterson v. ITT Consumer Financial Corp.* (1993) 14 Cal.App.4th 1659, 1663.) In the trial court, all extrinsic evidence was submitted by written declaration, and is subject to de novo review.

IV. BACKGROUND FACTS

A. The Pools

The real parties in interest in this appeal are the members of the Non-Agricultural Pool and the Appropriative Pool.

The Non-Agricultural Pool was established for industrial and commercial users. (Judgment, III:47 AA495:24-27.) The water rights of the members of the Non-Agricultural Pool were "individually decreed" by the Judgment. (III:47 AA477:28-478:2.) The respective members of the Non-Agricultural Pool have "specific quantitative rights and shares in the declared Safe Yield." (III:47 AA482:1-3: AA531.) The Non-Agricultural Pool has its own pool committee (the "NAP Committee"). (III:47 AA488:20-25.) The NAP Committee consists of one representative for each member of the Non-Agricultural Pool. (III:47 AA536:9-11) There is no "at large" representation. (*Id.*)

The Appropriative Pool was established for appropriative users, principally municipal water districts. (III:47 AA495:28-496:2.) The members of the Appropriative Pool also have specific quantitative water rights. (III:47 AA482:1-3: AA532.) The Appropriative Pool Committee also consists of one representative of each member of the Appropriative Pool. (III:47 AA539:12-13.)

In contrast to the Non-Agricultural Pool and the Appropriative Pool, the members of the Agricultural Pool own their water rights collectively, not individually. (III:47 AA480:13-20.) The Agricultural Pool has hundreds of members, and the Agricultural Pool Committee is a representative committee, elected "at large" by the members of the Agricultural Pool. (III:47 AA533:17-27.)

Since 1978, several trial judges have presided over the underlying action. In September 2009, the underlying action was re-assigned to the Honorable Stanford Reichert. The motion appealed from was the first motion heard by Judge Reichert following the re-assignment of the case to him.

B. The NAP Committee

Under the Judgment, the role of the pool committees is limited. The sole authority granted to the pool committees by the Judgment is "the power and responsibility for developing policy recommendations for administration of its particular pool." (III:47 AA492:4-10.) Rarely do the members of the NAP Committee have a need or desire to develop new "policy recommendations" for the Non-Agricultural Pool. As a result, although Watermaster staff scheduled monthly meetings of the NAP Committee for many years prior to the occurrence of this dispute, the representatives did not attend the scheduled meetings. (VI:78 AA1360:4-

16.) Under the Judgment, the pool committees are not obligated to meet.[3]

Between December 21, 2007 and December 21, 2009, Watermaster staff scheduled 24 monthly meetings of the NAP Committee. (VI:78 AA1360:6-8.) At 13 of those 24 meetings, the representative of only 1 of 19 members attended. (VI:78 AA1360:6-10.) At the remaining 11 meetings, the representatives of only 2 of the 19 members attended. (*Id.*) In fact, the Chair himself attended only 1 of the 24 meetings during this two-year period. (VI:78 AA1360:10-11.)

Because only 10 of the 19 pool members owned Pre-2007 Storage Water, the Peace II Option only affects 10 of the 19 pool members. (VI:78 AA1360:12-13.) Those 10 members were even less active, for an even longer period than the Non-Agricultural Pool as a whole. Of the 10, nine had not attended a single meeting of the NAP Committee in the 6-year period between February 2004 and January 2010. (VI:78 AA1360:13-15.)

Monthly meetings of the NAP Committee were scheduled for the same dates, times, and location (Watermaster's offices) as the meetings of the Appropriative Pool Committee. Watermaster staff and counsel attended

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[3] The members of the Non-Agricultural Pool are generally operating companies, such as a company that owns and operates an automobile racetrack, a company that owns and operates a mobile home park and a company that manufactures steel. (Bowcock Decl. AA1359:25-26.) They are not water companies, but rather the water they use is a component of their business, similar to other utility services – be it water or natural gas, electricity or phone service. Each of the member companies of the Non-Agricultural Pool has appointed a single natural person as its representative to serve on the NAP Committee. (AA1359:15-18.) Those representatives are typically operating personnel for their respective companies (i.e., director of race track administration, general manager of mobile home park, environmental engineer). (AA1359:26-1360:3.) For these individuals, oversight of the water rights that their respective companies own and use is just one component of their job responsibilities.

the meetings. The fact that the Non-Agricultural Pool had little or no business to conduct, and that its members generally did not attend Watermaster meetings, was obvious and well-known to Watermaster staff, Watermaster counsel and the members of the Appropriative Pool.

C. The Peace II Option

In the fall of 2007, the Watermaster Board adopted Watermaster Resolution No. 07-05 (the "Peace II Resolution"). (IV:51 AA749-878.) Attachment G to the Peace II Resolution is the Purchase and Sale Agreement for the Purchase of Water by Watermaster from Overlying (Non-Agricultural) Pool that is referred to herein as the "Peace II Option". (IV:51 AA842-845 & AA38-41.) Attachment K to the Peace II Resolution is the Peace II Agreement. (IV:51 AA856-875.)

The Peace II Option provided a method by which storage water owned by certain members of the Non-Agricultural Pool might be transferred to Watermaster, as agent for all members of the Appropriative Pool, at a set price.[4] The Peace II Option defines the water subject to such transfer as the unused storage water owned by some of the individual members of the Non-Agricultural Pool on June 30, 2007, referred to herein as the "Pre-2007 Storage Water". (Peace II Option, I:7 AA38, §B.) Section C of the Peace II Option provided the mechanism pursuant to which Watermaster, as agent for the members of the Appropriative Pool, could acquire the Pre-2007 Storage Water:

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[4] Watermaster was not a real party in interest under the Peace II Option. Watermaster characterized its own role under the Peace II Option as being merely an "intermediary" or an "escrow holder" for the possible transfer. (Watermaster Brief, V:61 AA1013:10 & 13.)

> C. Notice. Within twenty-four months of the final Court approval of this Agreement ("Effective Date"), and only with the prior approval of the Appropriative Pool, Watermaster will provide written **Notice of Intent to Purchase** the Non-Agricultural (Overlying) Pool water pursuant to § 5.3(a) of the Peace Agreement, which therein identifies whether such payment will be in connection with Desalter Replenishment or a Storage and Recovery Program.

(I:7 AA39, § C (emphasis in original).) Section C makes clear that the Notice of Intent to Purchase was required to (a) be written; (b) be delivered no later than December 21, 2009 (i.e., the second anniversary of the court's approval of the Peace II Option); and (c) specifically identify whether the use of the Pre-2007 Storage Water was for Desalter Replenishment or a Storage and Recovery Program, both of which provided basin-wide benefits. The next section, Section D, of the Peace II Option provided that a portion of the purchase price for the Pre-2007 Storage Water would be payable within 30 days after the written Notice of Intent to Purchase was provided. (I:7 AA39§ D.)

Watermaster had no obligation to provide the written Notice of Intent to Purchase, or to purchase the Pre-2007 Storage Water, as the Peace II Option makes clear in Section H: "This Agreement will expire and be of no further force and effect if Watermaster does not issue its **Notice of Intent to Purchase** in accordance with Paragraph D above [sic] within twenty-four months of Court approval." (I:7 AA39, § H (emphasis in original).) The 10 affected members of the Non-Agricultural Pool could not legally compel Watermaster to deliver the written Notice of Intent to Purchase, and therefore could not compel Watermaster to purchase the Pre-2007 Storage Water. Indeed, Watermaster, as agent for the Appropriative Pool, could decline to provide the written Notice of Intent to Purchase, and

therefore could choose not to purchase the Pre-2007 Storage Water for any reason or for no reason at all. For example, if the value of the Pre-2007 Storage Water were less than the pre-determined purchase price, Watermaster could choose not to purchase the Pre-2007 Storage Water without obligation or liability.

The fact that the Peace II Option is a one-sided, unilateral contract is evident from the signature block on its final page. (I:7 AA40.) There are no signature blocks for Watermaster or the Appropriative Pool. (*Id.*) Only members of the Non-Agricultural Pool were understood to have any obligation under the Peace II Option unless and until the option was exercised. By its terms, and by its omission of any signature block for any party other than members of the Non-Agricultural Pool, neither Watermaster nor any member of the Appropriative Pool had any obligation under the Peace II Option to exercise the option, or to purchase the Pre-2007 Storage Water.

D. The Peace II Agreement

Watermaster was established by the Judgment and Watermaster's powers are limited and controlled by the Judgment. (Judgment, III:47 AA483:23-27.) As a creature of the Judgment, Watermaster has no authority to act in a manner inconsistent with the Judgment. (*Id.*)

In Section 4.1 of the Peace II Agreement, the parties agreed that all actions taken by Watermaster pursuant to the Peace II Resolution and the attachments thereto (including the Peace II Option) would be taken "in accordance with the grant and limitations on its discretionary authority set forth under paragraph 41 of the Judgment". (Peace II Agreement, IV:51 AA860, § 4.1.) Both because of the general nature of Watermaster, and the express agreement of the parties, all actions taken by Watermaster in

connection with the Peace II Option were governed by the Judgment, including the notice provisions thereof.

Under the Judgment, all notices from Watermaster are required to be provided personally or by U.S. mail. "Delivery to or service upon any party or active party by the Watermaster, by any other party, or by the Court, of any item required to be served upon or delivered to such party under or pursuant to the Judgment shall be made personally or by deposit in the United States mail, first class, postage prepaid, addressed to the designee at the address in the latest designation filed by such party or active party." (Judgment, III:47 AA502:24-503:3.) In fact, the Judgment makes clear in Paragraph 31 that no action by Watermaster of any kind is effective unless notice thereof is in writing, and delivered by U.S. mail. "Any action, decision or rule of Watermaster shall be deemed to have occurred or been enacted on the date on which written notice thereof is mailed." (Judgment, III:47 AA487:13-18.) Persons desiring to be relieved of receiving written notice by U.S. mail may file a waiver of notice with Watermaster, but the effect of filing such a waiver is removal from the notice list entirely. (Judgment, III:47 AA502:13-17.)

E. Watermaster's Repeated Characterization of the Contract As An Option

On December 21, 2007, the trial court entered an order (the "Peace II Court Order") approving the Peace II Resolution. (Order, III:50 AA719:15-17.) Following entry of the Peace II Court Order, Watermaster repeatedly and consistently, on numerous occasions, characterized the Peace II Option as an option. Where an agreement is unambiguous on its face, parol evidence is admissible and relevant to prove any meaning to which the agreement is reasonably susceptible. (Code of Civil Procedure §

1856(g).) And where an agreement is ambiguous, parol evidence is admissible to explain the ambiguity. (*Id.*) "[W]hen a contract is ambiguous, a construction given to it by the acts and conduct of the parties with knowledge of its terms, before any controversy has arisen as to its meaning, is entitled to great weight, and will, when reasonable, be adopted and enforced by the court. The reason underlying the rule is that it is the duty of the court to give effect to the intention of the parties where it is not wholly at variance with the correct legal interpretation of the terms of the contract, and a practical construction placed by the parties upon the instrument is the best evidence of their intention." (*Universal Sales Corp. v. California Press Mfg.* Co. (1942), 20 Cal.2d 751, 761 (citations omitted).)

In the Peace II Court Order, Judge Gunn ordered Watermaster to explain the Peace II Option in a brief to be submitted no later than February 1, 2008. (III:50 AA719:24-25.) In the brief thereafter filed, Watermaster acknowledged that Judge Gunn's order "arises out of concerns expressed by the Special Referee[5] regarding interpretation of the amendments in the event of future conflicts regarding their intended meaning." (Brief, V:61 AA997:24-25 (emphasis added).)

In the brief, Watermaster repeatedly and consistently referred to the Peace II Option as an option:

- "the members of the Non-Agricultural Pool have exercised their discretion to option the water to

[5] For many years, the trial court retained the services of a special referee, as a disinterested neutral, to advise the trial court in connection with actions taken and proposed by Watermaster, and in connection with controversies to which Watermaster was a party. In 2008, the trial court (Judge Wade presiding) issued an order directing the referee to take no further action.

Watermaster under the defined terms of the Purchase and Sale Agreement for the Purchase and Sale of Water by Watermaster from the Overlying (Non-Agricultural) Pool."

- "Watermaster now has discretion under the defined terms of the option to obtain the water for use either in connection with a storage and recovery project or for desalter replenishment."
- "The option gives Watermaster two years from the date of Court approval of the Peace II Measures (December 21, 2009) to evaluate whether it requires the water for the potential purposes."
- "In the event the Watermaster does not exercise its option to purchase the water held in storage and Watermaster and members of the Non-Agricultural Pool do not mutually agree to otherwise extend the date of the option, then the stored water will be made available for purchase by the members of the Appropriative Pool"
- "The special transfer . . . . is expressly deducted from the quantity available for Watermaster, or in the event Watermaster does not exercise the option to the members of the Appropriative Pool."
- "The earmark helped to address concerns expressed over the delays between the time the original financial terms were negotiated for the Purchase and Sale Agreement and the time at which the option may be finally exercised by Watermaster"
- "it should be noted that there is no requirement that Watermaster purchase the water made available"

(V:61 AA1003:19-20, 24-25, 27-28; 1004:4-5, 13-16, 22-25; 1005:8-10 (emphasis added).)

In January 2009, at a Watermaster Board meeting, Watermaster counsel conceded that Section C of the Peace II Option was an option. According to the official minutes of the January 22, 2009 Watermaster Board meeting, Watermaster counsel stated the following:

> Watermaster can exercise the option and buy the water and use it for a Storage & Recovery Agreement or, 2)

> Watermaster can use it in connection with Desalter replenishment. The agreement has a two year shelf life; and that agreement would expire at the end of 2009. If Watermaster fails to exercise its option rights to purchase the water in this calendar year, that water would then default back and be made available to the Appropriators under another provision of the Peace II Agreement.

(VI:81 AA1370, §3 (emphasis added).)

Even after the dispute regarding its exercise arose, Watermaster continued to characterize the Peace II Option as an option. After belatedly claiming to have provided notice of exercise of the Peace II Option, Watermaster tendered payment under the Peace II Option in mid-January 2010. In a letter dated January 14, 2010 from the Watermaster CEO to the Chair of the NAP Committee, the Watermaster CEO conceded that the Section C of the Peace II Option was an option:

> As you may recall, Watermaster entered into discussions and negotiations with parties in the Basin, and these conversations resulted in our Peace II settlement agreement. Part of that document allows for the sale of water in storage from the Non-Agricultural Pool to the Appropriators. In accordance with this provision, the Appropriators have exercised their option to purchase the stored water.

(VI:82 AA1372 (emphasis added).) On January 17, the Watermaster CEO sent 10 additional letters to the 10 affected members of the Non-Agricultural Pool, purporting to tender payment to each of them. These 10 additional letters contained identical language regarding the character of the Peace II Option: "In accordance with this provision, the Appropriators have exercised their option to purchase the stored water." (VI:83 AA1373 (emphasis added).)

Finally, in a telephonic meeting with members of the Non-Agricultural Pool on January 18, 2010, Watermaster counsel referred to the

Peace II Option nearly a dozen times as an option agreement. (I:20 AA96-110, passim.)

Watermaster parties, including Watermaster counsel, have repeatedly and consistently characterized the Peace II Option as an option. They have used the term "option" to describe the Peace II Option because it is, both in common parlance and legally, an option. The practical construction repeatedly placed on the Peace II Option by Watermaster is the best evidence of its meaning.

V. ARGUMENT

A. The Peace II Option Is An Option

The Peace II Option satisfies the various judicial definitions of an option contract. The Peace II Option constituted a unilateral offer that was never accepted.

1. The Peace II Option Satisfies All Judicial Definitions of An Option

Under California law, an option is "a contract by which an owner gives another the exclusive right to purchase his property for a stipulated price within a specified time." (*County of San Diego v. Miller* (1975) 13 Cal.3d 684, 688.) The Peace II Option satisfies this simple definition. Watermaster had the exclusive right to purchase the Pre-2007 Storage Water for a fixed price and within a fixed time. (I:7 AA38-39, §§ B-D.)

The California Supreme Court recently expounded specifically upon the distinction between an option and a purchase contract, holding that whether a contract is an option or a purchase contract must be determined from its substance, not its title. (*Steiner v. Thexton* (2010) 48 Cal.4th 411, 418.) "[T]he label of an agreement is not dispositive. Rather, we look through the agreement's form to its substance. (*Id.*) Consistent with that

principle, the Court enumerated the two "classic features" that define an option, and that distinguish it from a purchase contract. (*Id.*) First, an option requires the seller to hold open an offer to sell property at a pre-determined price for a fixed period of time. (*Id.*) Second, the buyer has the power to accept the offer, but is not obligated to do so. (*Id.*) On the basis of these two factors, the Supreme Court found that the contract in question was an option, not a purchase contract. (*Id.*) The fact that another provision of the contract in question made clear that the buyer had no liability for failing to buy was an additional but not necessary factor in the Supreme Court's consideration. (*Id.* at pp. 418-419.)

The Peace II Option contains the two "classic features" enumerated by *Steiner v. Thexton*: (1) the Peace II Option required the affected members of the Non-Agricultural Pool to hold open an offer to sell the Pre-2007 Storage Water for a pre-determined price until December 21, 2009; and (2) Watermaster had the power to accept the offer, but had no obligation to do so. Section H of the Peace II Option made clear that if Watermaster did not exercise the option, the Peace II Option would expire, and Watermaster would have no further liability or obligation. (I:7 AA39, §H.)

A long line of California appellate decisions are consistent with the California Supreme Court's holdings in *County of San Diego v. Miller* and *Steiner v. Thexton*. "The distinction between a contract to purchase or sell real estate and an option to purchase is, that the contract to purchase or sell creates a mutual obligation on the one party to sell and on the other to purchase, while an option merely gives the right to purchase within a limited time without imposing any obligation to purchase." (*Menzel v. Primm* (1907) 6 Cal.App. 204, 209; *quoted with approval* in *Jonas v.*

Leland (1947) 77 Cal.App.2d 770, 776; *Caras v. Parker* (1957) 149 Cal.App.2d 621, 626; and *Schmidt v. Beckelman* (1961) 187 Cal.App.2d 462, 469-470.) The Peace II Option satisfies this test for an option, because Section C gave Watermaster the right to purchase the Pre-2007 Storage Water, without imposing any obligation upon Watermaster to do so.

Another line of cases has further simplified the distinction between an option and a purchase contract. "[T]he test of whether an instrument is an option or a contract of sale is whether there is such an obligation on the part of the optionee to buy that it can be enforced by specific performance". (*Scarbery v. Bill Patch Land & Water Co.* (1960) 184 Cal.App.2d 87, 100; *Welk v. Fainbarg* (1967) 255 Cal.App.2d 269, 276; *People v. Ocean Shore R. Co.* (1949) 90 Cal.App.2d 464, 474.) Again, the Peace II Option satisfies this description of the test for an option, because Section H demonstrates that there was no obligation by Watermaster to deliver the written Notice of Intent to Purchase, and the 10 affected members of the Non-Agricultural Pool could therefor neither compel Watermaster to deliver the written notice nor compel Watermaster to purchase the Pre-2007 Storage Water. (I:7 AA39, §H.)

Myriad characteristics of that agreement demonstrate that Section C of the Peace II Option was an option. The Peace II Option was a unilateral offer. Consistent with this fact, it contains only a signature block for the Non-Agricultural Pool. (I:7 AA40.) At the time it became effective, Section C of the Peace II Option was intended to be binding only upon the affected members of the Non-Agricultural Pool. Watermaster, on the other hand, had no obligation to deliver a written Notice of Intent to Purchase pursuant to Section C. In fact, Section H of the Peace II Option expressly provided that if Watermaster did not deliver a written Notice of Intent to

Purchase, then the Peace II Option would "expire and be of no further force and effect." (I:7 AA39, §H.) Watermaster could allow the Peace II Option to terminate for any reason, including the possibility that a lower price or better deal existed elsewhere. Neither Watermaster nor the Appropriative Pool had any liability or obligation to the Non-Agricultural Pool under the Peace II Option if the Peace II Option expired.

Looking outside the plain language of the Peace II Option, on numerous occasions Watermaster staff and counsel publicly affirmed that Section C of the Peace II Option was an option. Those occasions included a legal brief filed by Watermaster counsel on behalf of Watermaster in the trial court expressly for the purpose of resolving, definitively, issues regarding interpretation of the provisions of the Peace II Option "in the event of future conflicts regarding their intended meaning." (Brief, V:61 AA997:24-25.) The trial judge required Watermaster, as a creature of the court, to provide a definitive interpretation of the Peace II Option in a court filing for the precise circumstances that the parties now find themselves in. The Non-Agricultural Pool is entitled to rely upon that interpretation, and Watermaster should be estopped from now asserting a diametrically opposite interpretation.

2. The Character of the Peace II Option Was Not Affected by the Term "Condition Subsequent"

The character of the Peace II Option was not affected by the use of the term "condition subsequent" in Section H thereof. A condition is not a covenant. The existence of a condition does not change an option into a bilateral or mutual agreement.

In fact, the use of the term "condition subsequent" in Section H of the Peace II Option is entirely consistent with the character of the Peace II

Option as an option. The California Supreme Court has recognized that an option naturally involves a condition subsequent, which does not change the character of the option as a unilateral promise. "Since the optionor promises to perform the contract to which the option relates, *subject to a condition at the discretion on the part of the optionee*, an option contract involves a *unilateral* promise to perform the obligations of the contract to which the option relates." (*Dawson v. Goff* (1954) 43 Cal.2d 310, 317).

"An option, as a matter of legal theory, is considered to have a dual nature," and can be seen from two different "viewpoints." *Palo Alto Town & Country Village, Inc. v. BBTC Co.* (1974) 11 Cal.3d 494, 503-504.) From the viewpoint of the optionee, the option notice can be considered a condition precedent (i.e., occurs before the formation of a binding purchase obligation). From the viewpoint of the optionor, the option notice can be considered a condition subsequent (i.e., occurs after the option has been created).

Whether the giving of notice, or any other act by Watermaster, is seen as a condition precedent or a condition subsequent, the reference to "condition subsequent" in Section H of the Option Agreement confirms, rather than contradicts, that the Peace II Option is an option.

3. The Character of the Peace II Option Was Not Affected By Other Peace II Measures

The fact that the Peace II measures included other agreements and covenants, some of which may have been mutual or bilateral, does not affect the option character of the Peace II Option. In many reported decisions that bear upon this appeal, the option at issue was included within a contract that contained other covenants that were mutual or bilateral, some or all of which had been performed. For example, in *Bekins Moving*

& Storage Co. v. Prudential Insurance Co. of America (1986) 176 Cal.App.3d 245, the option at issue was contained in an office lease with a 10-year term. (*Id.* at 248.) The option was not exercisable, and the dispute did not arise, until the end of the term, after nearly ten years of mutual or bilateral performance of the other covenants in the lease. (*Id.* at 248-249.) In *Simons v. Young* (1979) 93 Cal.App.3d 170, the option at issue was contained in a residential lease with a two-year term, and again the option at issue was not exercisable, and the dispute did not arise, until the end of the term. (*Id.* at 174-175.) In *Hayward Lumber & Inv. Co. v. Construction Products Corp.* (1953) 117 Cal.App.2d 221, the option at issue was contained in an industrial lease with a 1-year term, and again the option was not exercisable, and the dispute did not arise until the end of the term. (*Id.* at 223-225.) In each of these cases the option was recognized as an option by the courts, and enforced as an option. In none of these cases was the option disregarded because other elements of the contract were bilateral or mutual.

The Peace II Option is on its face a unilateral agreement, to be signed only by members of the Non-Agricultural Pool, and binding only upon the affected members of the Non-Agricultural Pool. The Peace II Option has the "classic features" of an option and satisfies the judicial definitions for an option. The fact that the Peace II measures of which the Peace II Option was a part included other instruments or covenants does not prevent the Peace II Option from being an option.

B. Watermaster Failed to Exercise the Option in Accordance With Its Terms

The Peace II Option, the Peace II Agreement and the Judgment obligated Watermaster to deliver the Notice of Intent to Purchase in writing

by U.S. mail. Not only did Watermaster fail to provide the Notice of Intent to Purchase in writing by U.S. mail, no notice was given to the affected members of the Non-Agricultural Pool. (I:2 AA30:3-7; II:28-35 (Bowcock Decl. ¶26; Penrice Decl. ¶4; Stubbings Decl. ¶3; Arbelbide Decl. ¶3; Geye Decl. ¶3.; Lawhn Decl. ¶3; Starnes Decl. ¶3; Ward Decl. ¶3.))

1. A Party Must Strictly Perform Any Notice Requirements Necessary to Exercise an Option

Because the Peace II Option was an option, Watermaster was required to strictly comply with the requirements for exercising the option. "An option is an offer by which a promisor binds himself in advance to make a contract if the optionee accepts the terms and within the time designated in the option. Since the optionor is bound while the optionee is free to accept or not as he chooses, courts are strict in holding an optionee to exact compliance with the terms of the option." (*Hayward Lumber & Inv. Co. v. Construction Prod. Corp.* (1953) 117 Cal.App.2d 221, 229 (emphasis added); *Simons v. Young* (1979) 93 Cal.App.3d 170, 182; *Bekins Moving & Storage Co. v. Prudential Insurance Co.* (1985) 176 Cal.App.3d 245.) "[W]here, as here, the acceptance or the 'election' or the 'exercise' of the option is by the terms of the contract to be made in a particular manner, it must be strictly so made in order to constitute a valid acceptance." (*Callisch v. Franham* (1948) 83 Cal.App.2d 427 (option to purchase real estate).)

The Ninth Circuit Court of Appeals, applying California law, has held that "where the option is to be exercised within a stated time and in a particular manner, that must be done exactly as prescribed." *Cummings v. Bullock* (9th Cir. 1966) 367 F.2d 182, 183 (emphasis added). The Ninth Circuit further stated:

> The result may seem harsh, and the rules applied are technical. But the decisions cited make the reason clear. An option, given for consideration, binds the optionor, and but it does not bind the optionee. He may, if he chooses, walk away from the deal. That is why the language of the option agreement is construed in favor of the optionor and why the courts require that the optionee comply strictly with whatever conditions the agreement imposes upon his right to exercise the option if he chooses to do so.

(*Cummings v. Bullock*, 367 F.2d at p. 186.) The California Supreme Court has specifically cited this portion of *Cummings* with approval. (*Holiday Inns of America, Inc. v. Knight* (1969) 70 Cal.2d 327, 330.)

The courts have expressly rejected substitutes for strict compliance, such as constructive notice or inquiry notice. In *Hayward*, thirty days before the expiration of the lease (which was also the deadline for the tenant to exercise an option to renew), the tenant (represented by Mr. Wells) cured monetary defaults under the lease by payments to the landlord (represented by Mr. Hubbard) in order to avoid default. (*Hayward*, 117 Cal.App.2d at p. 224.) If the lease were in default, the option could not be exercised, and both landlord and tenant knew that tenant's curative payment was made solely for the purpose of preserving the option. (*Id.*) In fact, at the time the curative payment was made, landlord and tenant had the following conversation: "Mr. Hubbard said to me 'Obviously, after going to all the trouble to wire that money to me last night, you must be intending to stay" and I said 'Yes, obviously'." (*Id.*) The Court held that neither the verbal assurance nor the curative payment were proper substitutes for written notice. (*Id.* at p. 228.)

In another leading case, Bekins, as tenant under a 10-year office lease, had an option to renew the lease. (*Bekins*, 176 Cal.App.3d at p. 248.) The deadline to exercise the option was June 30, 1981. (*Id.*) In anticipation of renewal, Bekins elected to install new air conditioning units,

at very considerable expense, to serve the premises. (*Id.*) During the period February through June 1981, Bekins, as tenant, and Prudential, as landlord, communicated frequently about the air conditioning work which Bekins was then performing. (*Id.*) Under the lease, the new air conditioning equipment would become landlord's property if the option were not exercised, so installation of the air conditioning equipment only made sense if tenant intended to exercise the option. Bekins claimed that its actions and communications constituted constructive notice and/or substantial compliance. (*Id.* at p. 251.) The Court held that performance of the air conditioning work by Bekins was not a substitute for written notice. (*Id.*) The extensive written and oral communications between Prudential and Bekins about the air conditioning did not constitute written notice, and did not constitute a waiver by Prudential of the requirement for written notice. (*Id.*)

Here, the form and method of delivery of the written Notice of Intent to Purchase were set forth in the Peace II Option, the Peace II Agreement and the Judgment. In the Peace II Option, the form of delivery of the Notice of Intent to Purchase was specified as written notice (I:7 AA39, § C), and in the Peace II Agreement, Watermaster further agreed that all of Watermaster's actions in connection with the Peace II Option would be taken in accordance with its authority under the Judgment. (Peace II Agreement, IV:51 AA860, § 4.1.) Even if the parties had not so agreed, Watermaster, as a creature of the Judgment, was bound to act in accordance with the Judgment, including the notice provisions thereof. The notice provisions of the Judgment required written notice by U.S. mail. (III:47 AA502:24-503:3). The law requires strict compliance with these provisions regarding notice.

(a) Written Notice of Intent Was Not Provided in August 2009

The trial court erred in finding that Watermaster satisfied the notice requirements of the Peace II Option by circulating an email on or about August 21. The August 21 email stated only that agendas and packages for August 27 meetings of the Advisory Committee and Watermaster Board were available for download on the ftp section of Watermaster's website. (I:21 AA111.) The email contained no other information, and provided no other notice. (*Id.*) It also contained no attachments. (*Id.*) In fact, the August 21 email was in the same generic form as emails on the same subject circulated by Watermaster staff for years previously. (VI:78 AA1361:8-12.) The email made no mention of the Peace II Resolutions, the Peace II Agreement, the Peace II Option or the written Notice of Intent to Purchase. (I:21 AA111.) Nor did the email reflect any action actually taken by Watermaster – it was simply an email regarding a future meeting of the Watermaster Board. (*Id.*) The e-mail was not a written Notice of Intent to Purchase.

The ftp portion of Watermaster's website contains numerous folders and hundreds of documents. A person who received the August 21 email and wanted to find the agenda or agenda package for the then-upcoming August 27 meeting of the Watermaster Board would have had to navigate to Watermaster's ftp website (I:2 AA30:15-31:3 & I:22), then find the correct folder within the ftp website among numerous folders (I:2 AA30:15-31:3 & I:23), then find the correct agenda package among numerous files. (I:2 AA30:15-31:3 & I:24.) If the agenda package were located, the person could have attempted to open up the agenda package. However, the agenda package was a 39.50MB pdf file, consisting of 144

pages. (I:2 AA30:15-31:3 & I:25.) Buried in the middle of the agenda package was a two-page staff report which described its one-page attachment as a "form of notice" being submitted to the Watermaster Board for possible approval. (I:2 AA30:15-31:3 & I:25 AA165-167) The "form of notice" was for consideration only, had not been approved, and was not final. If the August 21 email was notice of anything, it was only notice that one of many regular meetings of the Watermaster Board would occur in the future.

The trial court also erred in finding that sufficient notice was provided by virtue of participation by the alternative representative of the NAP Committee at the August 27 meeting of the Watermaster Board. First, the written Notice of Intent to Purchase was not even final on August 27. The meeting minutes show that there was substantial discussion regarding the substance of the proposed notice, and lingering uncertainty about the Appropriative Pool's intended use of the Pre-2007 Storage Water. (I:13 AA68-69.) The "form of notice" presented by Watermaster staff to the Watermaster Board stated on its face that 36,000 acre feet of the Pre-2007 Storage Water would be used in a Storage and Recovery Program, and the remaining 2,652 acre feet would be used for Desalter replenishment. (I:25 AA167.) But the August 27 minutes also show that the Fontana Water Company requested additional time to consider the allocation between Storage and Recovery and Desalter replenishment. (I:13 AA68.) In addition, at the August 27 meeting the Watermaster CEO informed the Watermaster Board that the Appropriative Pool was considering an entirely different allocation, referred to as "Plan B". (*Id.*) Pursuant to Plan B, the Appropriative Pool might not use the Pre-2007 Storage Water for either Storage and Recovery Program or Desalter replenishment, but might

instead hold the Pre-2007 Storage Water "in reserve". (*Id.*)

In the end the substance of the written Notice of Intent to Purchase was not approved by the Watermaster Board on August 27. As requested by the Fontana Water Company, and as recommended by the Advisory Committee, the substance of the notice was referred back to the Appropriative Pool for consideration by the Appropriative Pool at its next monthly meeting. (I:13 AA69.) The official minutes of the August 27 meeting state that the Board "Moved to approve the Intent to Purchase to 36,000 acre feet for use in a Storage and Recovery Agreement, and refer the 2,652 acre-feet back to the Appropriative Pool for further consideration and a separate motion". (*Id.* (emphasis added).)

The Peace II Option mandated that the intended use of the Pre-2007 Storage Water be stated in the written Notice of Intent to Purchase. The Board's action demonstrates that on August 27, 2009, the intended use was not final and the written Notice of Intent to Purchase was not final. The notice of exercise of the Peace II Option could not have been provided on or before August 27.

(b) Written Notice of Intent to Exercise the Peace II Option Was Not Provided After August 2009

At the next meeting of the Appropriative Pool Committee, on October 1, 2009, the Appropriative Pool re-considered the intended uses of the Pre-2007 Storage Water. (I:14 AA74-75.) According to the official minutes of that meeting, there remained disagreement among members of the Appropriative Pool about how the Pre-2007 Storage Water should be used. (I:15 AA77, § II.A.) Watermaster staff recommended that a portion be used for desalter replenishment, but the Fontana Water Company wanted to use the water for a different purpose. (*Id.*) The official meeting minutes

show the Appropriative Pool Committee voted to "table the item for 30 days for further discussion and possible Watermaster staff recommendations". (*Id.*) Thus, as of October 2009, the intended use was still not final and as a result, the written Notice of Intent to Purchase was not final. Because the written Notice of Intent to Purchase was not final, it could not be given.

At the next meeting of the Appropriative Pool, on November 5, 2009, Watermaster staff submitted a report to the Appropriative Pool reminding it of the need to deliver the written Notice of Intent to Purchase. The staff report read, in part, as follows:

> Under the Purchase and Sale Agreement, Watermaster, at the direction of the Appropriative Pool, is to issue a Notice of Intent to Purchase to the Non-Agricultural Pool within 24 months after Court approval of the Peace II Documents. Thus the Notice of Intent to Purchase must be issued by December 21, 2009.

(I:16 AA80.) Furthermore, the November 5 staff report confirmed unequivocally that Watermaster had still not provided the written Notice of Intent to Purchase:

> Staff recommends that the Appropriative Pool direct Watermaster to issue the Notice of Intent to Purchase prior to December 21, 2009 and place the water purchased in storage pursuant to the proposed Plan.

(I:16 AA81.)

However, at the same November 5, 2009 meeting, the Appropriative Pool considered the so-called "Plan B". (I:17 AA84, § VII.1.) Plan B was described in bullet-point form on a single page, and provided as follows:

> (1) By December 21, 2009, Watermaster, under the direction of the Appropriative Pool, will send the Notice of Intent to Purchase pursuant to the Purchase and Sale Agreement.

* * *

(4) Watermaster shall hold the Purchased Water Account in trust for the members of the Appropriative Pool, and shall allocate the water held in the Purchased Water Account according to direction from the Appropriative Pool.

* * *

(8) If the water in the Purchased Water Account has not been utilized in a Storage and Recovery Program or Desalter Replenishment within 3 years from the date it is placed into the storage account, then the Appropriative Pool may elect to distribute the water according to the same formula used to allocate the cost of purchasing the water from the Non-Agricultural Pool.

(I:16 AA82.)

Watermaster could not possibly have prepared or provided a valid written Notice of Intent to Purchase consistent with Plan B. First, the Peace II Option required that the written Notice of Intent to Purchase state the intended uses of the Pre-2007 Storage Water. (I:7 AA39, §C.) Yet Plan B provided that its intended use would be "according to direction from the Appropriative Pool". (I:16 AA82.) As of November 5, the Appropriative Pool had still not finalized the intended use of the Pre-2007 Storage Water. The written Notice of Intent to Purchase could still not be finalized, and could not be provided.

Moreover, the Peace II Option unequivocally allowed only two uses – a Storage and Recovery Program and Desalter replenishment. (I:7 AA39, §C.) Both of these uses had basin-wide benefits. But paragraph 8 of Plan B purported to allow the Appropriative Pool the discretion to store the Pre-2007 Storage Water for three years, and then distribute the storage water directly to themselves, for their own consumptive use. (I:16 AA82.) Instead of using the Pre-2007 Storage Water for the two allowed uses, under Plan B the members of the Appropriative Pool could simply pocket

the water, to benefit themselves alone.

At the November 19, 2009 meeting of the Advisory Committee, and at the November 19, 2009 meeting of the Watermaster Board, Watermaster staff submitted to both the Advisory Committee and the Watermaster Board the Appropriative Pool's Plan B, but only as a report and not as an action item. (I:19 AA88 & AA92.) Watermaster staff did not request that the Advisory Committee or the Watermaster Board approve Plan B, and for good reason. Plan B violated the terms of the Peace II Option, and could not validly have been approved or implemented.

By November 5, 2009, Watermaster counsel and staff had publicly acknowledged, and reminded the Appropriative Pool and the Watermaster Board multiple times that the written Notice of Intent to Purchase had not been provided. On November 5, Watermaster staff requested authority to issue the written Notice of Intent to Purchase: "Staff recommends that the Appropriative Pool direct Watermaster to issue the Notice of Intent to Purchase prior to December 21, 2009". (I:16 AA81.) By November 19, 2009, the Appropriative Pool had deviated so far from the terms of the Peace II Option that no valid notice could be given.

(c) Announcement and Payment Were Inconsistent With the Peace II Option

On January 7, 2010, during a public meeting of the Appropriative Pool at which Watermaster staff was present, a representative of one of the members of the Non-Agricultural Pool asked Watermaster staff whether and when the written Notice of Intent to Purchase had been provided. (I:29 AA268, ¶5 & I:2 AA28, ¶22.) Following the question, the Watermaster CEO and the Watermaster counsel looked at each other, then conferred privately with one another for an extended period of time, and

then the Watermaster CEO stated "We will have to get back to you". (I:29 AA268, ¶5 & I:2 AA28 ¶22.)

Section D of the agreement required Watermaster to pay the first installment of the purchase price for the Pre-2007 Storage Water within 30 days. (I:7, AA39, § D.) If the written Notice of Intent to Purchase in fact had been provided in August 2009, then payment would have been made in September 2009. But Watermaster did not tender payment until mid-January 2010, just a few days after a Non-Agricultural Pool member first questioned whether and when the written Notice of Intent to Purchase was provided. (I:2 AA29, ¶24; I:29 AA269 ¶8; VI:82 & VI:83.) Tender of payment in January 2010 demonstrates that the written Notice of Intent to Purchase was not provided in August 2009, and neither Watermaster nor the Appropriative Pool believed it had been provided in August 2009.

2. Notice of Exercise of An Option Must Be Clear and Unambiguous

The party exercising an option must inform the optionor "in unequivocal terms of his unqualified intention to exercise his option". (Hayward, 117 Cal.App.2d at pp. 227-228; Bekins, 176 Cal.App.3d at p. 251.) "A clear and unambiguous notice, timely given, and in the form prescribed by the contract, is essential to the exercise of an option." (17B Corpus Juris Secundum (June 2009), Contracts, §446.)

The actions of Watermaster and the Appropriative Pool, which they now argue were sufficient to exercise the Peace II Option, were not notice of anything, and were filled with ambiguity, qualifications and equivocation. At the August 27 Board Meeting, the Watermaster Board referred the required contents of the written Notice of Intent to Purchase back to the Appropriative Pool Committee for "further consideration and a

separate motion." (I:13 AA69.) The Appropriative Pool Committee, at its next meeting on October 1, voted to "table the item for 30 days for further discussion and possible Watermaster staff recommendations". (I:15 AA77, § II.A.) Then, the Appropriative Pool Committee, at its next meeting on November 5, voted to adopt a Plan B that was facially invalid under the terms of the Peace II Option, and that was inconsistent with the August form of notice. (I:17 AA84, § VII.1.) The very fact that the Appropriative Pool Committee adopted Plan B on November 5 demonstrates that the Appropriative Pool did not consider the August form of notice to have been final, or given, on or prior to August 27.

All along, and as late as November 5, Watermaster staff was reminding the Watermaster Board and the Appropriative Pool that the written Notice of Intent to Purchase had still not yet been provided. (I:16 AA81.) Watermaster staff was responsible for giving the notice, and Watermaster staff was in a position to know whether or not the notice had been given. As late as November 5, Watermaster staff was still requesting authority to provide the written notice. (*Id.*)

The record amply demonstrates that no such notice was provided. If provided, it cannot reasonably be argued that such notice was "clear and unambiguous" or given in "unequivocal terms" or expressed an "unqualified intention".

C. Actual Communication Was Required

Section C of the Peace II Option required Watermaster to "provide" written Notice of Intent to Purchase. The Merriam-Webster Dictionary defines the term "provide" as follows: "to put (something) into the possession of someone for use or consumption." (*Merriam-Webster Online Dictionary*, www.merriam-webster.com.) The synonyms of "provide" are

"deliver, feed, give, hand, hand over, supply". (*Id.*) A person cannot put something into the possession of another, or deliver, feed, give, hand over or supply something to another, without actually giving it to the other person. The August 21 e-mail did not "provide" the written Notice of Intent to Purchase to the 10 members of the Non-Agricultural Pool whose Pre-2007 Storage Water was the subject of the Peace II Option.

Notice of exercise of an option is acceptance of an offer, and California law requires at the very least that acceptance of an offer be communicated to the offeror. (*Commercial Casualty Ins. Co. v. Industrial Acc. Comm.* (1953) 116 Cal.App.2d 901, 907; see also Miller & Starr California Real Estate 3d (2010), Contract Law, § 1:38 ("The acceptance of an offer to enter into a bilateral contract must be communicated to the offeror."); Cal.Jur.3d, Contracts (2011), § 81 ("To create a contract, acceptance of any offer must be communicated to the offeror.").) In *Erlich v. Granoff* (1980) 109 Cal.App.3d 920, the court held that an option could only be validly exercised by communicating exercise of the option to the optionor. "In the instant case the Erlichs exercised their option by communicating to Granoff in writing their election to accept his offer." (*Id.* at 929 (emphasis added).)

In *Bourdieu v. Baker* (1935) 6 Cal.App.2d 150, a case involving an option to purchase real property, the terms of the option provided that the option holder could exercise the option by paying or depositing the sum of $3,000 on or before November 1, 1928. (*Id.* at 153.) The option did not specify to whom the $3,000 was to be paid. (*Id.*) Prior to the deadline, the option holder deposited $3,000 with a bank, with instructions to deliver the sum to the seller upon demand. (*Id.* at 154.) The option holder also sent a letter to the seller informing him that the money had been deposited with

the bank. (*Id.* at 154-155.) Even though the contract did not specify to whom the money was deposited, simply making the money "available" was insufficient. "[N]o duty rested upon [the seller] to go to that bank or to make demand for the money." (*Id.* at 160-161.) The tender had to be made directly to the seller.

Likewise, in this case, the written Notice of Intent to Purchase was required, at the very least, to be communicated directly to the 10 affected members of the Non-Agricultural Pool. Making a written Notice of Intent "available" to them in a 39.50MB pdf file on a website that included many folders and many documents is not actual or direct communication. The 10 affected members of the Non-Agricultural Pool had no duty to sift through Watermaster's website each month to see whether they might happen to find a written Notice of Intent to Purchase. Sending an e-mail on August 21 that gave the members of the Non-Agricultural Pool no specific reason to search through those folders and documents is not actual or direct communication of acceptance of an offer.

D. The Participation by the Pool's Board Representative at the August 27 Meeting of the Watermaster Board Was Not Notice

Notice to the 10 affected members of the Non-Agricultural Pool could not legally be accomplished by participation of an alternate board member in the August 27 meeting of the Watermaster Board. Principally, as stated previously, the written Notice of Intent to Purchase was not even final on August 27.

Moreover, the alternate, Kevin Sage, was the representative of only one of the 19 members of the Non-Agricultural Pool – Vulcan. (VI:79 AA1364:12-13.) No member of the Non-Agricultural Pool other than Vulcan ever appointed Mr. Sage as its agent or representative. (*Id.*) In

particular, no member of the Non-Agricultural Pool other than Vulcan ever authorized Mr. Sage to act as its agent for giving or receiving notice. (*Id.*) In fact, Vulcan was not one of the 10 members of the Non-Agricultural Pool who was affected by the Peace II Option. (VI:83 AA1372-1373 & VI:84 AA1375-1376.) Vulcan had no Pre-2007 Storage Water, and had no economic interest in the Peace II Option. (*Id.*) Vulcan's interest was quite different than that of the 10 affected members. Even if the written Notice of Intent to Purchase had been final on August 27, its provision to Mr. Sage would have been ineffective.

Mr. Sage attended the August 27 board meeting as an alternate Watermaster Board member. (VI:79 AA1364:10-11.) Over the years, representatives of members of the Non-Agricultural Pool have been designated as Chair of the NAP Committee. Others have been designated as Vice Chair and Secretary. Still others have been designated as the representatives of the NAP Committee on the Advisory Committee and/or the Watermaster Board. Various other persons have been designated as alternates for some or all of these positions. Nothing in the Judgment makes any of these persons agents for the other members of the Non-Agricultural Pool. Nothing in the Judgment, for example, suggests that the Chair or the Vice Chair, or the representatives designated for the Advisory Committee or the Watermaster Board, or any of their alternates, could sell, or contract to sell or to option, another member's water rights, or otherwise act as agent with respect to the other member's individually decreed water rights.

In *O'Connor v. Chiascone* (1943) 130 Conn. 304, the Connecticut Supreme Court addressed a similar situation. In that case, the lease in question required that written notice of exercise of a five-year option to

renew be given to the landlord. At the time the lease was executed, the landlord was an individual. (*Id.* at 305.) At the time of exercise, the landlord was dead, and the tenant gave notice to the administrator of the landlord's estate. (*Id.*) The Connecticut Supreme Court held that the notice to the administrator was legally insufficient. (*Id.* at pp. 306-309.) Instead, the Supreme Court found that notice could only be given effectively to the heirs, because the heirs were the legal owners of the property in question. (*Id.*) The administrator was a fiduciary, but was also merely a fiduciary, and had duties to others besides the heirs. He was not the legal owner, and he was not the authorized agent of the heirs. (*Id.* at 307-308.) The administrator could not lease the property for a five-year term. Delivery of a notice to him purporting to renew the term for 5 years could not be effective. (*Id.*)

In *Kurek v. State Oil Company* (1981) 98 Ill.App.3d 6, the Illinois Court of Appeals came to the same conclusion on different facts. The landlord was a business trust. (*Id.* at 7.) A tenant gave notice of exercise of a renewal option to the beneficiary, rather than the trustee. (*Id.* at 8.) The tenant relied in part upon the fact that the beneficiary was the established point of contact for communications about the lease and that all rent payments were made by tenant directly to the beneficiary. (*Id.* at 7-8.) The Illinois Court held that notice to the beneficiary was legally ineffective. (*Id.* at 8-9.) While the beneficiary held the power of management, the trustee was the legal owner of the property. (*Id.*) The beneficiary was not the agent of the trustee. (*Id.* at 7.) They held different interests. Notice of exercise could not effectively be given to any person other than the legal owner. (*Id.* at 8-9.)

The sole purpose of the NAP Committee is "the power and

responsibility for developing policy recommendations for administration of its particular pool." (III:47 AA492:4-10.) The NAP Committee's powers are extremely limited by the Judgment. The water rights of the members of the Non-Agricultural Pool are individually decreed (III:47 AA495:28-496:2) and separately, not collectively, owned. (III:47 AA482:1-3: AA531. The members' water rights are not owned by the NAP Committee. The power of the committee's officers cannot be broader than that of the NAP Committee itself. Only a member may sell, or contract to sell or option, its water rights. Those decisions are made individually, not by action of the NAP Committee, or by its officers. Under the Judgment, the members appoint their own separate representatives to the NAP Committee, and Mr. Sage was the representative only of Vulcan.

Moreover, Mr. Sage's uncontrovered testimony, submitted by declaration to the trial court, was that at the Watermaster Board and other meetings he attended in August, September, October and November 2009, members of the Appropriative Pool specifically asked Watermaster counsel when the written Notice of Intent to Purchase would be provided. (I:28 AA266:10-19.) Watermaster counsel replied that the written Notice of Intent to Purchase would be provided, if at all, to the Non-Agricultural Pool on the "last possible date", i.e., on or about December 21, 2009. (*Id.*) The reference was to the future. Mr. Sage had no reason to believe on August 27 that the written Notice of Intent to Purchase had yet been provided to him, or to any member of the Non-Agricultural Pool. Even if Mr. Sage had been the agent of the other members of the Non-Agricultural Pool on August 27, and he was not, he was not provided with written notice of exercise of an option. To the contrary, he was plainly informed that the notice would be given, if at all, in the future.

The trial court found that not even one of the 10 affected members of the Non-Agricultural Pool received the written Notice of Intent (VI:93 AA1439:4-7), and none even knew it existed. (VI:93 AA1438:25-28.) The trial court's finding on this subject demonstrates that the notice was not communicated in any manner reasonably designed to apprise any or all of the 10 affected members of the Non-Agricultural Pool. The method of providing notice - if any notice was provided at all - was not even reasonable, let alone legally sufficient.

VI. CONCLUSION

For the foregoing reasons, the order of the trial court should be reversed. The Non-Agricultural Pool respectfully requests that the Court of Appeal issue a declaration that Watermaster did not provide the written Notice of Intent to Purchase in the manner required by the Peace II Option, the Peace II Agreement and the Judgment.

Dated: March 8, 2011

HOGAN LOVELLS US LLP

By _____
ALLEN W. HUBSCH

Attorneys for Appellant
Non-Agricultural (Overlying) Pool Committee

CERTIFICATE OF COMPLIANCE

I certify that, pursuant to California Rule of Court 8.204(c), the Opening Brief to which this certification is attached is proportionately spaced, has a typeface of 13 points, and contains 10,336 words, according to the counter of the word processing software with which it was prepared.

Dated: March 8, 2011

HOGAN LOVELLS US LLP

By _____
ALLEN W. HUBSCH

Attorneys for Appellant
Non-Agricultural (Overlying) Pool Committee

PROOF OF SERVICE

STATE OF CALIFORNIA)
) ss.
COUNTY OF LOS ANGELES)

I am employed in the County of Los Angeles, State of California. I am over the age of eighteen and not a party to this action. My business address is Hogan Lovells US LLP, 1999 Avenue of the Stars, Suite 1400, Los Angeles, CA 90067.

On **March 28, 2011,** I caused the foregoing document described as:

APPELLATE'S OPENING BRIEF

to be served on the interested parties in this action as follows:

[PLEASE SEE ATTACHMENT]

[X] **BY MAIL.** I sealed said envelope and placed it for collection and mailing following ordinary business practices.

[ ] **BY HAND DELIVERY.** I caused such envelope to be delivered by hand to the offices of the addressee(s) following ordinary business practices.

[ ] **BY FACSIMILE.** I served such document via facsimile to the facsimile number as indicated above.

[ ] **BY E-MAIL.** I caused such document(s) to be served via e-mail.

[ ] **BY OVERNIGHT SERVICE.** I caused such document to be delivered by overnight mail to the offices of the addressee(s) by placing it for collection by UPS/Federal Express following ordinary business practices by my firm, to wit, that packages will either be picked up from my firm by UPS/Federal Express and/or delivered by my firm to the UPS/Federal Express office.

[X] **(State)** I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. **Executed on March 28, 2011,** at Los Angeles, California.

Dolores Valencia
Print Name

Signature

PARTY AND ATTORNEY INFORMATION

Scott S. Slater, Esq. Michael T. Fife, Esq. Brownstein Hyatt Farber Schreck, LLP 21 East Carrillo Street Santa Barbara, CA 93101 Telephone: (805) 963-7000 Facsimile: (805) 965-4333 *Attorneys for Chino Basin Watermaster, Respondant*	Karin Dougan Vogel, Esq. Geoffrey K. Willis, Esq. Sheppard, Mullin, Richter & Hampton 501 West Broadway, Suite 1900 San Diego, CA 92101 *Attorneys for California Steel Industries, Inc., Movant and Appellant*
John Schatz, Esq. Attorney at Law P.O. Box 7775 Laguna Niguel, CA 92607-7775 Telephone: (949) 683-0398 Facsimile: (949) 305-6865 *Attorneys for Appropriative Pool, Respondant*	Supreme Court of California Office of the Clerk 350 McAllister Street San Francisco, CA 94102-4797 (FOUR COPIES)
Superior Court of California County of San Bernardino Chino Courthouse 13260 Central Avenue Chino, CA 91710 ~~(Four Copies)~~	

PROOF OF SERVICE

STATE OF CALIFORNIA)
) ss.
COUNTY OF LOS ANGELES)

I am employed in the County of Los Angeles, State of California. I am over the age of eighteen and not a party to this action. My business address is Hogan Lovells US LLP, 1999 Avenue of the Stars, Suite 1400, Los Angeles, CA 90067.

On **March 28, 2011,** I caused the foregoing document described as:

APPELLATE'S APPENDIX (VOLUME I – VII)

to be served on the interested parties in this action as follows:

[PLEASE SEE ATTACHMENT]

[X] **BY MAIL.** I sealed said envelope and placed it for collection and mailing following ordinary business practices.

[ ] **BY HAND DELIVERY.** I caused such envelope to be delivered by hand to the offices of the addressee(s) following ordinary business practices.

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[X] **(State)** I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. **Executed on March 28, 2011,** at Los Angeles, California.

Dolores Valencia
Print Name

Signature

PARTY AND ATTORNEY INFORMATION

Scott S. Slater, Esq. Michael T. Fife, Esq. Brownstein Hyatt Farber Schreck, LLP 21 East Carrillo Street Santa Barbara, CA 93101 Telephone: (805) 963-7000 Facsimile: (805) 965-4333 *Attorneys for Chino Basin Watermaster, Respondant*	Karin Dougan Vogel, Esq. Geoffrey K. Willis, Esq. Sheppard, Mullin, Richter & Hampton 501 West Broadway, Suite 1900 San Diego, CA 92101 *Attorneys for California Steel Industries, Inc., Movant and Appellant*
John Schatz, Esq. Attorney at Law P.O. Box 7775 Laguna Niguel, CA 92607-7775 Telephone: (949) 683-0398 Facsimile: (949) 305-6865 *Attorneys for Appropriative Pool, Respondant*	

4TH CIVIL NO.

E051653

In the Court of Appeal

OF THE

State of California

FOURTH APPELLATE DISTRICT
DIVISION TWO

NON-AGRICULTURAL (OVERLYING) POOL COMMITTEE
and CALIFORNIA STEEL INDUSTRIES, INC.
Defendants and Appellants,

v.

CHINO BASIN MUNICIPAL WATER DISTRICT, et al.
Plaintiffs and Respondents.

APPEAL FROM THE SAN BERNARDINO SUPERIOR COURT
HONORABLE STANFORD E. REICHERT, JUDGE
Case No. RCVRS 51010

APPELLANT CALIFORNIA STEEL INDUSTRIES, INC.'S OPENING BRIEF

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP
KARIN DOUGAN VOGEL, CAL. BAR NO. 131768
501 WEST BROADWAY, 19TH FLOOR
SAN DIEGO, CALIFORNIA 92101-3598
TEL: 619-338-6500

Attorneys for Appellant CALIFORNIA STEEL INDUSTRIES, INC.

TO BE FILED IN THE COURT OF APPEAL

APP-008

COURT OF APPEAL, FOURTH APPELLATE DISTRICT, DIVISION TWO	Court of Appeal Case Number: E051653
ATTORNEY OR PARTY WITHOUT ATTORNEY (Name, State Bar number, and address): Karin Dougan Vogel, Cal. Bar No. 131768 Sheppard Mullin Richter & Hampton LLP 501 West Broadway, Suite 1900 San Diego, CA 92101 TELEPHONE NO.: (619) 338-6500 FAX NO. (Optional): (619) 234-3815 E-MAIL ADDRESS (Optional): kvogel@sheppardmullin.com ATTORNEY FOR (Name): California Steel Industries, Inc.	Superior Court Case Number: RCVRS 51010 FOR COURT USE ONLY
APPELLANT/PETITIONER: NON-AGRICULTURAL (OVERLYING) POOL COMMITTEE and CALIFORNIA STEEL INDUSTRIES, INC. RESPONDENT/REAL PARTY IN INTEREST: CHINO BASIN MUNICIPAL WATER DISTRICT, et al.	
CERTIFICATE OF INTERESTED ENTITIES OR PERSONS BY FAX (Check one): ☒ INITIAL CERTIFICATE ☐ SUPPLEMENTAL CERTIFICATE	

Notice: Please read rules 8.208 and 8.488 before completing this form. You may use this form for the initial certificate in an appeal when you file your brief or a prebriefing motion, application, or opposition to such a motion or application in the Court of Appeal, and when you file a petition for an extraordinary writ. You may also use this form as a supplemental certificate when you learn of changed or additional information that must be disclosed.

1. This form is being submitted on behalf of the following party (*name*): California Steel Industries, Inc.

2. a. ☐ There are no interested entities or persons that must be listed in this certificate under rule 8.208.

b. ☒ Interested entities or persons required to be listed under rule 8.208 are as follows:

Full name of interested entity or person	Nature of interest (Explain):
(1) JFE Steel Corporation	Ownership Interest in California Steel Industries, Inc.
(2) Vale Limited	Ownership Interest in California Steel Industries, Inc.
(3)	
(4)	
(5)	

☐ Continued on attachment 2.

The undersigned certifies that the above-listed persons or entities (corporations, partnerships, firms, or any other association, but not including government entities or their agencies) have either (1) an ownership interest of 10 percent or more in the party if it is an entity; or (2) a financial or other interest in the outcome of the proceeding that the justices should consider in determining whether to disqualify themselves, as defined in rule 8.208(e)(2).

Date: September 1, 2010

KARIN DOUGAN VOGEL
(TYPE OR PRINT NAME)

▶ Karin Dougan Vogel
(SIGNATURE OF PARTY OR ATTORNEY)

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I.
INTRODUCTION

In 1978, the San Bernardino Superior Court entered a judgment in this case (Judgment), resolving legal and factual issues related to the water rights of scores of parties in the Chino Basin. The Judgment further established a protocol for regulating those water rights going forward. Consistent with that established protocol, defendant and appellant California Steel Industries, Inc. (CSI), a party with water rights controlled by the Judgment, joined in a post-judgment motion for a declaration (1) that a contract relating to the potential purchase of water from CSI's storage account is an option agreement (Peace II Option), and (2) that notice of exercise of the option was not given in the manner required by the agreement. The trial court, which the judgment specifically provides has continuing jurisdiction over such matters, issued its Order on June 18, 2010 (Order), concluding first that the Peace II Option is a purchase and sale agreement and not an option. Then the trial court determined that adequate notice under the agreement was provided. On both points, the trial court's ruling is in error, and should be reversed.

The Non-Agricultural (Overlying) Pool Committee filed the post-judgment motion that resulted in the trial court's Order. As a member of

the Non-Agricultural (Overlying) Pool[1], CSI had an interest in the motion, and therefore joined in it. Both the Non-Agricultural Pool Committee and CSI appealed from the Order. Pursuant to California Rules of Court, Rule 8.200, subdivision (a)(5), CSI joins in and adopts by reference the Opening Brief filed by the Non-Agricultural Pool Committee on March 28, 2011. CSI also makes the further arguments set forth below.

II.
APPEALABILITY OF THE APPEALED ORDER

The Judgment in this matter was signed by Howard B. Wiener, Judge of the Superior Court, on January 27, 1978, and filed on January 30, 1978. (III AA 467-560.) By its terms, the Judgment indicates: "Full jurisdiction, power and authority are retained and reserved to the Court as to all matters contained in this judgment, except [certain matters not relevant here]." (III AA 481, ¶ 15.) Paragraph 31 of the Judgment states:

> All actions, decisions or rules of Watermaster shall be subject to review by the Court on its own motion or on timely motion by any party, the Watermaster . . ., the Advisory Committee, or any Pool Committee, as follows:
>
> ***
>
> (e) Decision. The decision of the Court in such proceeding shall be an appealable supplemental order in this case.

---

[1] The Non-Agricultural (Overlying) Pool is referred to herein as the "Non-Agricultural Pool" and its committee is referred to as the "Non-Agricultural Pool Committee."

(*Id.* at 487-488, ¶ 31.) Because the Order is the final adjudication of appellants' "Motion . . . for Review of Watermaster Actions Pursuant to Section 31 of Judgment," it is appealable pursuant to paragraphs 15 and 31 of the Judgment. Further, it comes within the scope of Code of Civil Procedure, section 904.1, subdivision (a)(2), which provides that an appeal may be taken from an order made after a judgment.

CSI had standing to join in the motion in the trial court and to appeal from the Order because it is now a party to the Judgment. The Judgment states that it is "applicable to and binding upon not only the parties to this action, but also upon their respective . . . successors, assigns, . . ." (III AA 503, ¶ 63.) The parties to the action and the Judgment include the owners or those in possession of lands which overlie Chino Basin. (See, e.g., *id.* at 472, ¶ 1; 475, ¶ 5; 477-478, ¶ 8; 507-531.) One of those owners with overlying non-agricultural water rights was Kaiser Steel Corporation. (See III AA 531.) CSI is a successor and assign of water rights from Kaiser Steel Corporation. On March 18, 1993, the superior court entered its order approving the intervention by California Steel Industries, Inc., as a member of the Non-Agricultural Pool (see Order dated March 18, 1993, filed with the Court of Appeal on October 1, 2010). CSI has been bound by the Judgment ever since. As a successor party to the Judgment, CSI had standing to join in the motion of the Non-Agricultural Pool Committee and also to bring this appeal as a party aggrieved by the Order.

III.
THE TRIAL COURT ERRED IN INTERPRETING THE PEACE II OPTION

The fundamental error in the trial court's Order is its conclusion of law that the Peace II Option is not an option agreement. (VI AA 1429:8-13.) Because the rules of interpretation applicable to an ordinary contract differ from the rules of interpretation of an option, this fundamental legal error fatally colored the court's later conclusion that notice was properly given under the contract. Where an agreement is legally an option agreement, a party must ***unequivocally*** exercise the option ***exactly*** as specified in the contract. (See, e.g., *Hayward Lumber & Inv. Co. v. Construction Prod. Corp.* (1953) 117 Cal.App.2d 221, 227-229 [*Hayward*] ("To avail himself of an option of renewal given by a lease, a tenant must apprise the lessor in unequivocal terms of his unqualified intention to exercise his option in the precise terms permitted by the lease.").) When that stricter standard of interpretation is applied to the Peace II Option, the indefinite and continually shifting decisions and actions by Watermaster and the Appropriative Pool that the court found sufficient to provide notice not only failed to give notice as a matter of fact, but also failed as a matter of law. (See VI AA 1431-1441.)

In short, the trial court erred in finding the Peace II Option is not an option—it is. Then the trial court erred in finding Watermaster gave notice

that satisfied the terms of the contract—it did not. The Order should be reversed.

A. The Peace II Agreement Is An Option

The trial court found the Peace II Option is not an option because "¶H of the purchase and sale agreement [the Peace II Option] calls the written notice of intent and payment pursuant thereto [the exercise requirement] a condition subsequent." (VI AA 1429:12-14.) The court's interpretation of the contract is wrong for two reasons. First, labels in a contract (i.e., "purchase and sale agreement" or "condition subsequent") are not the controlling factor, the substance of the contract terms is. (*Steiner v. Thexton* (2010) 48 Cal.4th 411, 418 (whether a contract is an option is determined by its substantive terms, not by the labels used). Here, the substance of the Peace II Option dictates the legal conclusion that it is an option agreement. Second, the use of the "condition subsequent" label in paragraph H is *consistent* with a conclusion the Peace II Option is an option contract, not contradictory to it. In reality, an option is simply a condition subsequent, from the viewpoint of the optionor. (*Palo Alto Town & Country Village, Inc. v. BBTC Co.* (1974) 11 Cal.3d 494, 503-504 [*Palo Alto*].)

The Peace II Option includes all of the required terms of an option that distinguish it from an ordinary purchase and sale agreement. Under the law, a contract is an option and not a purchase and sale agreement where by

its terms (1) the seller must hold open an offer to sell property at a pre-determined price for a fixed period of time; and (2) the buyer may accept the offer but is not obligated to do so. (*Steiner*, *supra*, 48 Cal.4th at p. 418.) Here, the Peace II Option does just that. By its terms, the Non-Agricultural Pool members, including CSI, were required to hold open an offer to sell Pre-2007 Storage Water at a pre-determined price until December 21, 2009 (two years after court approval of the Peace II Option). (I AA 39, ¶ C.) The Appropriative Pool, through Watermaster, was entitled to accept that offer before the cutoff date but was not obligated to do so. (*Id.*) In fact, the Peace II Option expressly states that if Watermaster did not exercise the option, it would expire. (I AA 39, ¶ H.)

There was no confusion between the parties on the point that the Peace II Option is an option agreement. It was an offer to sell the Pre-2007 Storage Water at a pre-determined price for a fixed period of time, an offer that Watermaster could accept but was not required to accept. The contract was written to be an option agreement, Watermaster repeatedly described it as an option, Watermaster's counsel called it an option agreement, and all of the parties treated it like an option agreement. As discussed at length in the Non-Agricultural Pool Committee's Opening Brief, everyone agreed it was an option—everyone, that is, except the trial court. On this point, the trial court was plainly wrong.

B. Watermaster Failed to Exercise the Option According to Its Terms

Once it is determined that the Peace II Option is an option contract, under the law it only could be exercised in strict conformity with its terms. (*Callisch v. Franham* (1948) 83 Cal.App.2d 427 [*Callisch*].) In particular, the timing, manner and substance of exercise of the option must be exactly as called for in the option. (*Holiday Inns of America, Inc. v. Knight* (1969) 70 Cal.2d 327, 330, citing with approval, *Cummings v. Bullock* (9th Cir. 1966) 367 F.2d 182, 183.) Because the issue of whether notice was given under the Peace II Option is a question of contract interpretation answered by applying the law pertaining to option contracts, the issue must be reviewed de novo on appeal. (See, e.g., *Edmond's of Fresno v. MacDonald Group, Ltd.* (1985) 171 Cal.App.3d 598, 603.)

The Peace II Option set forth three terms required for its exercise: (1) it had to be exercised no later than December 21, 2009; (2) with the prior approval of the Appropriative Pool, Watermaster had to provide written notice of intent to purchase the Pre-2007 Storage Water; and (3) the written notice had to identify "whether such payment will be in connection with Desalter Replenishment or a Storage and Recovery Program." (1 AA 39, ¶ C.) As to the first criterion, the law regarding options mandates that the notice could not be even a day late (e.g., *Wightman v. Hall* (1923) 62 Cal.App. 632, 634). As to the second criterion, because the Peace II Option

required written notice, oral or constructive notice was not sufficient to exercise the option; it had to be written. (See, e.g., *Hayward*, 117 Cal.App.2d at p. 224 (neither a verbal assurance nor a curative payment was a proper substitute for written notice required by option contract); see also *Bekins Moving & Storage Co. v. Prudential Ins. Co.* (1985) 176 Cal.App.3d 245, 251 [*Bekins*] (neither constructive notice nor substantial compliance was a proper substitute for written notice under option agreement).) Finally, under the third criterion, the exercise of the option required that Watermaster choose between two uses for the water, either desalter replenishment or storage and recovery. If Watermaster gave notice that included some different allocation of the water that was not contemplated by the Peace II Option or no allocation of the water at all, the effect of such notice would have been a rejection of the option. (See *Hayward*, 117 Cal.App. 2d at p. 229 (by varying the terms of the option in his purported exercise of it, the defendant in effect rejected the option).)

Contrary to the conclusion of the trial court, Watermaster never did exercise the Peace II Option by providing the required notice. The court found two items constituted notice of intent to purchase under the Peace II Option: (1) the Watermaster board meeting minutes for the August 27, 2009 board meeting, that "were electronically distributed to interested parties" and "maintained on the watermaster website" (VI AA 1431:24-1432:2) and (2) the agenda for the same board meeting, which was posted

on the Watermaster website and provided to one member of the Non-Agricultural Pool at the August 27, 2009 meeting (VI AA 1433:28-1434:8). As discussed below, neither the agenda nor the later minutes for the August 27 board meeting constituted "exact compliance with the terms of the option." (See *Hayward*, 117 Cal.App.2d at p. 229.) Neither constituted a "valid acceptance" of the option agreement, and thus the Peace II Option was never exercised, as a matter of law. (See *Callisch*, 83 Cal.App.2d at p. 431.)

1. The Agenda for the August 27, 2009 Watermaster Board Meeting Did Not Constitute Exercise of the Peace II Option, No Matter the Form of Delivery

Courts have already held that actions preliminary to the exercise of an option, even if reflective of an intent to exercise the option, do not constitute *actual* exercise of the option. (See, e.g., *Hayward*, 117 Cal.App.2d at pp. 224, 228 (neither verbal assurance of intent to exercise the option nor a tenant's curative rent payment made with the intent of preserving the option constituted actual exercise of the option); *Bekins*, 176 Cal.App.3d at pp. 248, 251 (extensive written and oral communications between the parties about expensive property improvements installed by the tenant shortly before the deadline for exercising the option to renew a lease did not constitute exercise of the option).) Those holdings apply here, to the agenda for the August 27 Watermaster board meeting. An agenda is not notice of anything, except that a matter is scheduled to be discussed. At

best, the August 27 agenda was reflective of a potential intent to exercise the option. Under the law, notice of a potential or even probable intent to exercise an option is not actual exercise. (E.g., *Hayward, supra*; *Bekins, supra.*) Watermaster did not exercise the Peace II Option by circulating the August 27 agenda, regardless of whether the means of its circulation satisfied the option terms.[2]

2. The Minutes for the August 27, 2009 Watermaster Board Meeting Did Not Constitute Exercise of the Peace II Option, No Matter the Form of Delivery

While the minutes for the August 27 board meeting may have gone one step further in the process toward ultimately exercising the option, they too were preliminary to the exercise and did not constitute actual exercise. Those minutes show that the water allocation issue—the third necessary criterion for the exercise of the option—was not yet resolved. It remained unsettled after August 27 whether the water would be allocated to Storage and Recovery, or Desalter Replenishment, or some entirely different allocation that was not even contemplated by the Peace II Option. (See I AA 68.) Therefore, the notice was referred back to the Appropriative Pool for consideration at its next monthly meeting. (I AA 69.) The ultimate

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[2] In its Appellant's Opening Brief, the Non-Agricultural Pool Committee discusses in detail the ineffectiveness of the means by which Watermaster claims it gave notice of intent to purchase, and also the failure of Watermaster's chosen means of communication to comply with the exact

allocation decision, a critical term of the notice of intent to purchase, continued to be in flux throughout the fall of 2009, and nothing was resolved by the December 21, 2009 deadline. Because the law of options mandates that the exercise of the option be exactly as prescribed in the option itself, both as to the substance of the exercise as well as the timing and mechanics of it, the August 27 meeting minutes could not have constituted exercise of the Peace II Option as a matter of law. (See *Hayward*, 117 Cal.App.2d at pp. 226-229 (letter purporting to renew lease for one year where option was for two year period was an attempted alteration of the terms of the option that was tantamount to the rejection of the option).)

3. Notice Was Not Provided In a Manner Reasonably Likely to Reach CSI

Even if either the agenda or the minutes for the August 27 Watermaster board substantively complied with the terms of the Peace II Option (neither does), such purported notice was also improper because it was not provided in a manner reasonably likely to reach CSI or the other individual Non-Agricultural Pool members whose water was the subject of the option. In its Order, the trial court discussed at length the well-known factors that made it unlikely the individual members of the Non-

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terms of the Peace II Option. CSI does not repeat that discussion here, as it has joined in all of the Non-Agricultural Pool Committee's brief.

Agricultural Pool, including CSI, would be aware of the discussions and decisions of the Watermaster board. (E.g., VI AA 1420:19-1421:21.) In fact, many of the affected Non-Agricultural Pool members, including CSI, submitted declarations stating they never received any purported notice of intent to purchase. (VI AA 1428:6-23; II AA 28-35.) Based on these facts, the trial court found "there is no basis to conclude any of the other nonagricultural pool members [aside from Kevin Sage of Vulcan Materials Company] actually received the notice of intent." (VI AA 1439:4-7.) Nevertheless, the trial court was not concerned. Without relying on any legal authority, the court found actual *receipt* unnecessary so long as "written notice of intent was *provided* to the members of the nonagricultural pool," and the court found it was. (VI AA 1439:8-11 (emphasis added).)

Even if actual receipt is not necessary, however, simple *provision* of notice, without any restrictions on how or to whom or the circumstances under which notice is *provided*, is not enough. To the extent the Peace II Option is not crystal clear in its mandate as to how the written notice must be provided, one basic restriction is well-settled by law. The method of communication must be "reasonable." (See *Palo Alto*, 11 Cal.3d at pp. 499-500 (ordinary mail is reasonable method of delivery of written acceptance of option, and the exercise of the option is effective at time of deposit).) While in *Palo Alto* the Supreme Court found ordinary mail to be

a reasonable method of providing written notice, and registered mail not required, a mass mailing to a set zip code instead of a specific mailing to a set address would not have been reasonable. Nor would publication have been a reasonable method of providing the required written notice. The point being that to be reasonable, the provision of notice must be given in a manner reasonably likely to reach the party to whom the notice is intended to inform. Otherwise, what is the point of the notice requirement at all?

Here, the trial court conceded that Watermaster knew the individual members of the Non-Agricultural Pool, including CSI, did not attend the Non-Agricultural Pool meetings. Because they were not members of the Watermaster board or the Appropriative Pool, they did not attend the meetings of those groups either. Further, the court could easily infer that the individual members, including CSI, did not have a practice of searching the Watermaster website to find obscure references to matters that could be interpreted to be binding on them. Purported notice of exercise of the Peace II Option was not "provided" to CSI in a reasonable mode as required by law, where it was not reasonable to anticipate that CSI would receive either the agenda or meeting minutes for the August 27 meeting (and which did not provide notice in any event), and in fact CSI did not receive any notice Watermaster was exercising the option.

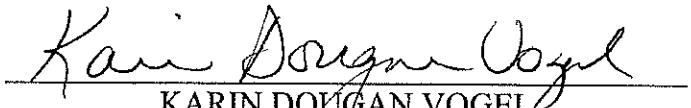
IV.
CONCLUSION

To avail itself of an option of purchasing CSI's Pre-2007 Storage Water, Watermaster had to apprise the CSI in unequivocal terms of its unqualified intention to exercise its option in the precise terms permitted by the Peace II Agreement. It failed to do so and the Peace II Option expired.

For all of the foregoing reasons, as well as for the reasons set forth in the Appellant's Opening Brief filed by the Non-Agricultural Pool Committee, in which CSI joins, the Order of the trial court should be reversed. CSI respectfully requests that the Court of Appeal issue a declaration that the Peace II Option is an option agreement, that Watermaster did not provide the written Notice of Intent to Purchase in the manner required by the Peace II Option, and therefore the Peace II Option was never exercised and has expired.

Dated: April 6, 2011

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

By 

KARIN DOUGAN VOGEL
Attorneys for Appellant
CALIFORNIA STEEL INDUSTRIES, INC.

CERTIFICATE OF COMPLIANCE

I certify that, pursuant to California Rule of Court 8.204(c), the attached Appellant's Opening Brief is proportionately spaced, has a typeface of 13 points, and contains 3,352 words, according to the counter of the word processing program with which it was prepared

Dated: April 6, 2011

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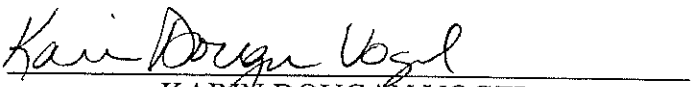
By 

KARIN DOUGAN VOGEL
Attorneys for Appellant
CALIFORNIA STEEL INDUSTRIES, INC.

California Court of Appeal, Fourth Appellate District, Division Two
Non-Agricultural (Overlying Pool) Committee and California Steel Industries, Inc. v. Chino Basin Municipal Water District, et al., Case No. E051653

PROOF OF SERVICE
STATE OF CALIFORNIA, COUNTY OF SAN DIEGO

I am employed in the County of San Diego; I am over the age of eighteen years and not a party to the within entitled action; my business address is 501 West Broadway, Suite 1900, San Diego, California 92101.

On **April 6, 2011,** I served the following document(s) described as **APPELLANT CALIFORNIA STEEL INDUSTRIES, INC.'S OPENING BRIEF** on the interested party(ies) in this action by placing true copies thereof enclosed in sealed envelopes and/or packages addressed as follows:

John J. Schatz, Esq.
P.O. Box 7775
Laguna Niguel, CA 92607-7775
Telephone: (949) 683-0398
Facsimile: (949) 305-6865
Attorneys for Appropriative Pool

Allen Hubsch, Esq.
Hogan Lovells US LLP
1999 Avenue of the Stars, Suite 1400
Los Angeles, CA 90067
Telephone: (310) 785-4600
Facsimile: (310) 785-4601
Attorneys for Non-Agriculture Pool

Scott Slater, Esq.
Michael T. Fife, Esq.
Brownstein Hyatt Farber Schreck, LLP
21 East Carrillo Street
Santa Barbara, CA 93101-2706
Telephone: (805) 963-7000
Facsimile: (805) 965-4333
Attorneys for Chino Basin Watermaster

Chino Basin Watermaster
Kenneth R. Manning, Chief Executive Officer
9641 San Bernardino Road
Rancho Cucamonga, CA 91730
Facsimile: (909) 484-3890

Superior Court of California
County of San Bernardino
Hon. Stanford E. Reichert
13260 Central Avenue
Chino, CA 91710

California Supreme Court
Via electronic service

☒ **BY MAIL:** I am "readily familiar" with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with the U.S. postal service on that same day with postage thereon fully prepaid at San Diego, California in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing in affidavit.

☒ **STATE:** I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed on **April 6, 2011**, at San Diego, California.

Pamela Parker
PAMELA PARKER

Con
CHINO BASIN WATERMASTER
Case No. RCV 51010
Chino Basin Municipal Water District v. The City of Chino

PROOF OF SERVICE

I declare that:

I am employed in the County of San Bernardino, California. I am over the age of 18 years and not a party to the within action. My business address is Chino Basin Watermaster, 9641 San Bernardino Road, Rancho Cucamonga, California 91730; telephone (909) 484-3888.

On April 7, 2011 I served the following:

1. **PARAGRAPH 31 APPEAL OPENING BRIEFS BY:**
   - **NON- AGRICULTURAL POOL**
   - **CALIFORNIA STEEL INDUSTRIES, INC.**

/_x_/ BY MAIL: in said cause, by placing a true copy thereof enclosed with postage thereon fully prepaid, for delivery by United States Postal Service mail at Rancho Cucamonga, California, addresses as follows:
See attached service list: Mailing List 1

/___/ BY PERSONAL SERVICE: I caused such envelope to be delivered by hand to the addressee.

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I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Executed on April 7, 2011 in Rancho Cucamonga, California.

Alex Perez
Chino Basin Watermaster

KEN WILLIS
1425 WEST FOOTHILL BLVD.
SUITE 220
UPLAND, CA 91786

ROBERT BOWCOCK
INTEGRATED RESOURCES MGMNT
405 N. INDIAN HILL BLVD
CLAREMONT, CA 91711-4724

STEVE ELIE
IEUA
16405 DOMANI TERRACE
CHINO HILLS, CA 91709

GEOFFREY VANDEN HEUVEL
CBWM BOARD MEMBER
8315 MERRILL AVENUE
CHINO, CA 91710

PAUL HOFER
11248 S TURNER AVE
ONTARIO, CA 91761

BOB KUHN
669 HUNTERS TRAIL
GLENDORA, CA 91740

CHARLES FIELD
4415 FIFTH STREET
RIVERSIDE, CA 92501

TOM HAUGHEY
CITY OF CHINO
PO BOX 667
CHINO, CA 91708-0667

JOHN MURA
CITY OF CHINO HILLS
14000 CITY CENTER DRIVE
CHINO HILLS, CA 91709

GLEN DURRINGTON
5512 FRANCIS ST
CHINO, CA 91710

BOB FEENSTRA
P.O. BOX 17482
ANAHEIM HILLS, CA 92817

KEN JESKE
709 NOTTINGHAM DRIVE
REDLANDS, CA 92373

Members:

Alfred E. Smith	asmith@nossaman.com
Allen W. Hubsch	allen.hubsch@hoganlovells.com
Andrew Lazenby	lazenbyag@bv.com
Art Kidman	akidman@mkblawyers.com
Barbara Swanson	Barbara_Swanson@yahoo.com
Beth Barry	bethb@cvwdwater.com
Bob Feenstra	bobfeenstra@gmail.com
Carol	marie@tragerlaw.com
Carol Davis	cdavis@lagerlof.com
Chris Swanberg	chris.swanberg@corr.ca.gov
Dan McKinney	dmckinney@rhlaw.com
Eric Garner	elgarner@bbklaw.com
Fred Fudacz	ffudacz@nossaman.com
Jean Cihigoyenetche	Jean_CGC@hotmail.com
jeeinc@aol.com	jeeinc@aol.com
Jennifer Novak	jennifer.novak@doj.ca.gov
Jill Willis	jnwillis@bbklaw.com
Jim Markman	jmarkman@rwglaw.com
Jim@city-attorney.com	Jim@city-attorney.com
jimmy@city-attorney.com	jimmy@city-attorney.com
John Cotti	jcotti@localgovlaw.com
John Schatz	jschatz13@cox.net
Joseph S. Aklufi	AandWLaw@aol.com
Karin Vogel	KVogel@sheppardmullin.com
Kuperberg, Joel	jkuperberg@rutan.com
Marguerite P Battersby	pbattersby@sheppardmullin.com
Mark Hensley	mhensley@localgovlaw.com
Michelle Staples	mstaples@jdplaw.com
Randy Visser	RVisser@sheppardmullin.com
Rodney Baker	rodbaker03@yahoo.com
smt@tragerlaw.com	smt@tragerlaw.com
Steve Kennedy	skennedy@bbmblaw.com
Steven K. Beckett	skbeckett@bbmblaw.com
Steven Lee	slee@rhlaw.com
Steven R. Orr	sorr@rwglaw.com
Tom Bunn	TomBunn@Lagerlof.com
Tom McPeters	THMcP@aol.com
Tram Tran	ttran@mkblawyers.com
William J. Brunick	bbrunick@bbmblaw.com
William P. Curley	wcurley@rwglaw.com

Members:

Al Lopez	lopezsixto@netzero.net
Alice Shiozawa	afshioza@gswater.com
Andy Campbell	acampbell@ieua.org
Andy Malone	amalone@wildermuthenvironmental.com
Anthony La	ala@ci.upland.ca.us
April Woodruff	awoodruff@ieua.org
Arnold Rodriguez	jarodriguez@sarwc.com
Ashok Dhingra	ash@akdconsulting.com
Ben Lewis	benjamin.lewis@gswater.com
Ben Pak	bpak@cbwm.org
Bill Kruger	citycouncil@chinohills.org
Bill Thompson	bthompson@ci.norco.ca.us
Bob Bowcock	bbowcock@irmwater.com
Bob Feenstra	bobfeenstra@gmail.com
Bob Feenstra	feenstra@agconceptsinc.com
Bob Kuhn	bgkuhn@aol.com
Bob Lawhn	rlawhn@rrienergy.com
Bonnie Tazza	bonniet@cvwdwater.com
Brenda Fowler	balee@fontanawater.com
Brian Geye	bgeye@autoclubspeedway.com
Brian Hess	bhess@niagarawater.com
Carl Hauge	chauge@water.ca.gov
Charles Field	cdfield@att.net
Charles Moorrees	cmoorrees@sawaterco.com
Cheyanne Reseck-Francis	cheyanne.reseck.francis@ieua.org
Chris Berch	CBerch@ieua.org
Chuck Hays	chays@fontana.org
Cindy Cisneros	Cindy_Cisneros@ci.pomona.ca.us
Cindy LaCamera	clacamera@mwdh2o.com
Craig Stewart	Craig.Stewart@amec.com
Curtis Paxton	cdpaxton@aol.com
Curtis Stubbings	Curtis_Stubbings@praxair.com
Dan Arrighi	darrighi@sgvwater.com
Dan Hostetler	dghostetler@csupomona.edu
Danielle Soto	danielle_soto@CI.POMONA.CA.US
Daryl Grigsby	daryl_gribsby@ci.pomona.ca.us
Dave Argo	argodg@bv.com
Dave Crosley	DCrosley@cityofchino.org
David D DeJesus	tvmwddiv2rep@gmail.com
David D DeJesus	davidcicgm@aol.com
David Penrice	dpenrice@acmwater.com
David Ringel	david.j.ringel@us.mwhglobal.com
David Starnes	david.starnes@mcmcnet.net
Debbie Espe	despe@sdcwa.org
Dennis Mejia	dmejia@ci.ontario.ca.us
Dennis Poulsen	dpoulsen@californiasteel.com
Dennis Williams	dwilliams@geoscience-water.com
Diana Sturgeon	dsturgeon@chinohills.org
Don Cutler	dcutler@jcsd.us
Don Galleano	donald@galleanowinery.com
Donna Stokes	dstokes@cityofchino.org
Earl Elrod	earl.elrod@verizon.net
Edward Gonsman	Edward.Gonsman@cdcr.ca.gov
Eldon Horst	ehorst@jcsd.us
Eric Fordham	eric_fordham@geopentech.com
Eunice Ulloa	eulloa@cbwcd.org
Frank Brommenschenkel	frank.brommen@verizon.net
Frank LoGuidice	faloguidice@sgvwater.com
Gene Koopman	GTKoopman@aol.com
Geoffrey Kamansky	gkamansky@niagarawater.com
Geoffrey Vanden Heuvel	GeoffreyVH@juno.com
Gerald Yahr	yahrj@koll.com

Geye, Brian	BGeye@autoclubspeedway.com
Gloria Rivera	gloriar@cvwdwater.com
Grace Cabrera	grace_cabrera@ci.pomona.ca.us
Greg Woodside	gwoodside@ocwd.com
Ida Martinez	idam@cvwdwater.com
Isabel Martinez	imartinez_wfa@verizon.net
Jack Safely	jsafely@wmwd.com
James Jenkins	cnomgr@airports.sbcounty.gov
James McKenzie	jmckenzie@dpw.sbcounty.gov
Jean Perry	JPerry@wmwd.com
Jeff Pierson	jpierson@unitexcorp.com
Jeffrey L. Pierson	jpierson@intexcorp.com
Jill Willis	jnwillis@bbklaw.com
Jim Hill	jhill@cityofchino.org
Jim Taylor	jim_taylor@ci.pomona.ca.us
Jo Lynne Russo-Pereyra	jolynner@cvwdwater.com
Joe Graziano	jgraz4077@aol.com
Joe P LeClaire	jleclaire@wildermuthenvironmental.com
John Anderson	janderson@jeua.org
John Bosler	JohnBo@cvwdwater.com
John Huitsing	johnhuitsing@gmail.com
John Kennedy	jkennedy@ocwd.com
John Mura	jmura@chinohills.org
John Rossi	jrossi@wmwd.com
John Salmon	jsalmon@mkblawyers.com
Jon Lambeck	jlambeck@mwdh2o.com
Jorge Rosa Jr.	Jorge.Rosa@sce.com
Julie Cavender	julie.cavender@cdcr.ca.gov
Justin Brokaw	jbrokaw@hughes.net
Karen Johnson	kejwater@aol.com
Kathy Kunysz	kkunysz@mwdh2o.com
Kathy Tiegs	Kathyt@cvwdwater.com
Ken Eke	keke@dpw.co.san-bernardino.ca.us
Ken Jeske	kjcwater@hotmail.com
Ken Kules	kkules@mwdh2o.com
Ken Waring	kwaring@jcsd.us
Kenneth Willis	cbwmeo@gmail.com
Kevin Austin	kaustin@californiasteel.com
Kevin Blakeslee	kblakeslee@dpw.sbcounty.gov
Kevin Sage	Ksage@IRMwater.com
Kim Morris	kmorris@fontana.org
Kurt Berchtold	kberchtold@waterboards.ca.gov
Kyle Snay	kylesnay@gswater.com
Lindsay Gomez	lgomez@wildermuthenvironmental.com
Lisa Hamilton	Lisa.Hamilton@corporate.ge.com
Marguerite P Battersby	pbattersby@sheppardmullin.com
Maribel Sosa	Maribel_Sosa@ci.pomona.ca.us
Marsha Westropp	MWestropp@ocwd.com
Martin Zvirbulis	martinz@cvwdwater.com
Michelle Lauffer	mlauffer@jcsd.us
Mike Thies	mthies@spacecenterinc.com
Neil Miller	neil_miller@ci.pomona.ca.us
W. C. "Bill" Kruger	wkrugers@earthlink.net
W. C. "Bill" Kruger	citycouncil@chinohills.org

Members:

Manuel Carrillo	Manuel.Carrillo@SEN.CA.GOV
Maria Klachko Blair	mklachko-blair@bhfs.com
Maria Linzay	mlinzay@ci.upland.ca.us
Maria Mendoza	mmendoza@wildermuthenvironmental.com
Mark Kinsey	mkinsey@mvwd.org
Mark Ward	mark_ward@ameron-intl.com
Mark Wildermuth	mwildermuth@wildermuthenvironmental.com
Marla Doyle	marla_doyle@ci.pomona.ca.us
Martha Davis	mdavis@ieua.org
Martin Rauch	martin@rauchcc.com
Maynard Lenhert	directorlenhert@mvwd.org
Melanie Otero	melanie_otero@ci.pomona.ca.us
Michael Camacho	MCamacho@pacificaservices.com
Michael T Fife	MFife@bhfs.com
Mike Maestas	mmaestas@chinohills.org
Mike Williams	mwilliams@airports.sbcounty.gov
Mindy Sanchez	msanchez@ieua.org
Mohamed El-Amamy	melamamy@ci.ontario.ca.us.
Moore, Toby	TobyMoore@gswater.com
Nate Mackamul	Nate.Mackamul@cdcr.ca.gov
Nathan deBoom	n8deboom@gmail.com
Pam Sharp	PSharp@chinohills.org
Pam Wilson	pwilson@bhfs.com
Pat Glover	pglover@cityofchino.org
Patrick Sheilds	psheilds@ieua.org
Paul Deutsch	paul.deutsch@amec.com
Paul Hofer	farmwatchtoo@aol.com
Paula Lantz	paula_lantz@ci.pomona.ca.us
Peggy Asche	peggy@wvwd.org
Pete Hall	r.pete.hall@cdcr.ca.gov
Pete Hall	rpetehall@gmail.com
Peter Hettinga	peterhettinga@yahoo.com
Phil Krause	pkrause@parks.sbcounty.gov
Phil Rosentrater	prosentrater@wmwd.com
Randy Lee	rlee@ieua.org
Raul Garibay	raul_garibay@ci.pomona.ca.us
Rick Hansen	rhansen@tvmwd.com
Rick Rees	Richard.Rees@amec.com
Rob Vanden Heuvel	Robert.t.van@gmail.com
Robert C. Hawkins	RHawkins@earthlink.net
Robert Cayce	rcayce@airports.sbcounty.gov
Robert DeLoach	robertadeloach1@gmail.com
Robert Neufeld	robneu1@yahoo.com
Robert Nobles	Robert.Nobles@cdcr.ca.gov
Robert Tock	rtock@jcsd.us
Robert Young	rkyoung@fontanawater.com
Roger Han	roger_han@praxair.com
Ron Craig	RonC@rbf.com
Sam Fuller	samf@sbvmwd.com
Sandra S. Rose	directorrose@mvwd.org
Sandy Lopez	slopez@ci.ontario.ca.us
Sarah Kerr	skerr@ci.ontario.ca.us
Sarah Schneider	sarah.schneider@amec.com
Scott Burton	sburton@ci.ontario.ca.us
Scott Slater	sslater@bhfs.com
Shaun Stone	sstone@ci.upland.ca.us
Sheri Rojo	smrojo@aol.com
Sherrie Schnelle	Sschnelle@chinohills.org
Sondra Elrod	selrod@ieua.org
Sonya Bloodworth	sbloodworth@wmwd.com
Steve Nix	snix@chinohills.org
Steve Riboli	steve.riboli@sanantoniowinery.com

Steven J. Elie	selie@ieua.org
Steven J. Elie	s.elie@mpglaw.com
Ted Leaman	tleaman@sunkistgrowers.com
Terry Catlin	tlcatlin@wfajpa.org
Tim Hampton	tim_hampton@ci.pomona.ca.us
Tim Mim Mack	tmimmack@ci.ontario.ca.us
Tim Skrove	tskrove@mwdh2o.com
Tom Cruikshank	tcruikshank@spacecenterinc.com
Tom Harder	tharder@thomashardercompany.com
Tom Haughey	tom@haugheyinsurance.com
Tom Love	TLove@ieua.org
Toni Medel	mmedel@rbf.com
Tracy Tracy	ttracy@mvwd.org
Van Jew	vjew@mvwd.org
Vicki Hahn	vhahn@tvmwd.com
William P. Curley	wcurley@rwglaw.com
WM Admin Staff	