



State of Idaho

DEPARTMENT OF WATER RESOURCES

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DIRK KEMPTHORNE
Governor

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Director

August 19, 2004

ERO RESOURCES CORP.
ATTN STEVE HANNULA
1106 N COLE RD SUITE C
BOISE ID 83704-8661

RE: APPLICATIONS FOR TRANSFERS IB WATER RIGHT 63-31439

Dear Mr. Hannula:

Our office received your 7/16/2004 package that included the additional information needed for the five transfers on water right 63-31439 (Pacific Hide and Fur Depot). This letter is to address the memo included with this package from McKay, Trull, Tuel, and MacDonald.

I have spoken with my supervisor on this issue to ensure that the information that I am giving you is as accurate as possible. The memo requests that the primary ground water right being transferred to lands currently covered by canal water retain its primary status.

The memo describes the need to use ground water because the surface water or canal water right is not reliable. The contractor that constructed the system did not design the system to meet all the water users needs in the subdivision. Moving a primary water right to this type of scenario is needed, because the surface water is generally not available when needed due to the poor system design.

The department does not wish financial hardship on the subdivision owners, nor are we going to require that surface water system be redesigned to meet the individual user's needs. Therefore, we can grant a transfer that will allow each of the water users to design an irrigation system that only utilizes their ground water. The transfer can also allow the surface water to be re-introduced into the system if the surface water irrigation system issues are ever resolved.

However, this scenario does present some serious problems. By approving this transfer, we allow the water users the ability to choose between using surface/canal water or groundwater with the transfer. By allowing this choice to exist, it ties or binds these two water rights together. Once the two rights are bound together, it becomes very difficult to separate them again. Essentially, they become dependent on each other and actually become one water use. In order for us to approve the transfer in this manner, we will probably have to use the following two conditions:

If the surface water right(s) appurtenant to the place of use is sold, transferred, leased or used on any other place of use, this right to divert groundwater shall not be used without an approved transfer pursuant to Section 42-222, Idaho Code, or approval of the Department if a transfer is not required.

The right holder shall make full beneficial use of all surface water rights available to the right holder for irrigation of the lands authorized to be irrigated under this right. The right holder shall limit the diversion of ground water under this right to those times when the surface water supply is not available or the surface water supply is not reasonably sufficient to irrigate the place of use authorized under this right.

The key words in the second condition are "when the surface water is not available or surface water supply is not reasonably sufficient to irrigation the place of use." This allows the transfer applicants to irrigate with ground water as long as their current surface water system is not adequate to supply the entire subdivision. This would be legal under these conditions. However, if the homeowners association redesigned the surface water system, and it became more beneficial to use the surface water, then the applicants would need to use the surface water or canal water. This would be to their benefit, since it is always cheaper to use surface water, then to pump ground water.

Your clients do have the option of selling or turning back their canal rights to the canal company prior to approval of the transfer. This will take away their ability to use surface water, and the only irrigation source then available to them will be the ground water. This would maintain the primary status of the ground water right and the current value of the water right.

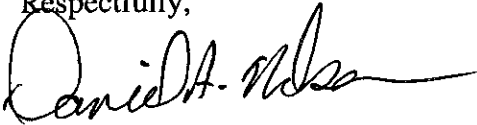
The biggest thing to consider in this scenario is what will bring the largest end return to the value of the water right and the land. Having a dual irrigation system that provides an option of using ground water and/or surface water will increase the value of the property. How much that value will be is unknown, but it is a definite bonus compared to others who have to depend solely on surface water or ground water for irrigation. The value of the ground water right when tied to the surface water will go down, because it will only be able to be sold to folks in a similar situation with surface and groundwater needs. However, the loss in value of the water right may be compensated by the increase in value of the property.

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I will continue with processing of these applications. It will take several weeks to complete the processing required. This will give your clients the opportunity to discuss this situation and determine what direction would be in their best interests. If they do sell the surface water off of the property, they will need to contact me prior to approval of the transfer. If they don't contact me prior to approval of the transfer, then the above conditions will be placed on the water rights.

This is a very difficult situation, so if you or your clients have any questions or concerns please contact me at the above address.

Respectfully,

A handwritten signature in black ink, appearing to read "Daniel A. Nelson", with a long horizontal flourish extending to the right.

Daniel A. Nelson
Sr. Water Right Agent