

## **Liquid Gold: Nestlé's deal for a water-bottling plant in a Mount Shasta mill town sets off a fierce legal battle that splits the community.**

California Lawyer  
By Glen Martin

For Drew Bassak, a partner at Manatt, Phelps & Phillips in San Francisco, it is one of those cases that joined vocation and avocation. More than that: For Bassak, fly-fishing isn't just a hobby. It's a passion, close to a religion, an affirmation of who he is and what he believes. And the McCloud River--a gin-clear stream fed by springs on the flanks of Mount Shasta--is where Bassak practices some of his most earnest devotions.

"The McCloud is a challenging river to fish," Bassak says. "It's fast water running through rugged terrain. But it's incredibly beautiful in that canyon. I remember one afternoon in particular. I was with a Manatt partner and we were fishing dry flies. There was bright sunshine, the sound of the river, the trout dimpling the water as they sucked up the mayflies. We caught one fish after another, all native trout. That day will stay with me the rest of my life."

So Bassak took it personally when he heard from local environmentalists that Nestlé Waters North America, a subsidiary of the Swiss-based conglomerate and the world's largest water bottler, planned to build a million-square-foot bottling plant in the town of McCloud. The proposed plant, to be constructed on the site of an old lumber mill, would siphon water from three springs that feed the McCloud and Squaw Valley Creek, put it in plastic bottles as Arrowhead Water, and transport it via tractor trailers--about 300 truckloads a day, more or less--as far away as Los Angeles.

"No one really had any idea what the plant's effect would be on the watershed and the fisheries," Bassak says. "Obviously, something had to be done." At Bassak's urging, Manatt agreed this spring to represent California Trout, a fisheries-conservation group, and other opponents of the project.

McCloud was founded in 1897 as a company town of the McCloud River Lumber Co. The owners prospered by harvesting the huge old-growth conifers that once cloaked Mount Shasta's slopes and the surrounding watershed. The workers lived in company housing, were cared for by company doctors when they were sick or injured, and bought food and sundries at the company store.

Then the big trees were all cut, and tougher environmental regulations made it difficult to harvest second- and third-growth timber. McCloud slowly became a town populated by retired mill hands, urban transplants, fly-fishing fanatics, and--because Mount Shasta is considered by some to be a holy site--New Age pilgrims.

From the insular perspective of McCloud's main street, the issues surrounding the bottling plant seem strictly local: compensation for the water and the promise of a few hundred jobs. But as the dispute has mushroomed to involve trout streams, groundwater, and the plant's broader environmental impacts, McCloud has found itself at the center of a larger debate over the social acceptability of bottled water.

Once viewed as an emblem of youth and health awareness, bottled water now has serious image problems. Several recent studies have shown that tap water is just as healthy, or healthier--so good, in fact, that some water companies actually fill their bottles with it. Worse, the water companies use up lots of energy making those plastic bottles, running the plants, and fueling the trucks that haul the water around.

Earlier this year, the U.S. Conference of Mayors adopted a resolution to examine the environmental impact of bottled water. At the time many U.S. cities--Los Angeles and San Francisco among them--had already taken measures to restrict bottled water.

Although the broader environmental battle is far from over, McCloud's dispute has given opponents of bottled water new focus and energy. It has also turned the town's 1,300 residents against one another, engendering bitterness and vituperation that could fester for years. As both sides know, the real fight here is about economic survival--finding some way to replace the long-gone timber jobs that once sustained the community.

Even so, none of this ripples the surface in McCloud. It's all pine trees, wildflower-spangled meadows, blue skies, and old pickups. Mount Shasta, California's signature volcanic cone, stands sentinel just to the north. Dogs snooze along the town's streets, unthreatened by the scant traffic. You can almost see the Zzzzs rising in thought balloons above their heads.

It is both the great fortune and burden of the McCloud Community Services District to hold rights to springs that produce large quantities of absolutely pure, delicious water. Spring water is one of the town's main amenities, a compelling reason to live here. Once the last lumber mill closed for good in 2002, the water became a potential lifeline--a renewable resource that could be transformed into jobs and municipal revenue. And for Nestlé it is cold, clear, liquid gold.

Three times in the 1990s the community services district--McCloud's only local government entity--tried and failed to sell the spring water to a bottled-water company. In 2000 the district conducted a feasibility study for bottling and marketing the water itself, but concluded that it would be better off partnering with an established company. So in 2003 the district's board reached a tentative

agreement with Nestlé Waters to sell up to 1,600 acre-feet--or 520 million gallons--of spring water a year. Nestlé also would be allowed to take unlimited groundwater from the area.

In return, the company promised the district annual payments of up to \$350,000 and the creation of 240 jobs. That September the district board presented the proposal at a town meeting in the elementary school gym, fielded questions for about 90 minutes, and then voted on the spot to approve the agreement.

Bassak says reading the contract for the first time is something he will never forget. "It was the most one-sided agreement I had ever seen," he says. "I admit I don't know the company's production costs, but they'd pay about \$115 a day for water that they'll retail for about \$5.5 million. That's a markup of roughly 4.5 million percent. The other astounding thing is that during periods of drought or shortage, Nestlé would get water before McCloud's residents. Nor is there any price adjustment over the contract, which runs 50 years with a 50-year extension option. So a century from now, the company could still be paying \$115 a day, unadjusted for inflation."

Doris Dragseth, one of the district board members who approved the agreement, sticks by her contention that McCloud got the best deal it could, noting that other bottlers had walked away from the prospect of building plants when they perceived the terms would not be favorable.

And Robert J. Saperstein, outside counsel for Nestlé and a shareholder at the Santa Barbara office of Brownstein Hyatt Farber Schreck, says the contract was by no means out of line. Rather, he says, it reflects similar contracts the company holds in other places around the state, and conforms to standard water law.

"It could have been [just] a typical industrial water contract, but in fact it offered significantly more to the district," Saperstein says. "You pay for a hookup, you agree on a rate structure, and you pay something for exclusivity. [Opponents of the deal] emphasize that the rates under the contract were low compared to what they'd be in Southern California. But McCloud isn't in Southern California--water sells for different rates in the north and the south. Nobody pays south-state rates in the north. That was one of the things that drew Nestlé to McCloud in the first place."

Nevertheless, some of McCloud's residents regarded the agreement as a sweetheart deal for Nestlé. In 2004 the opponents formed Concerned McCloud Citizens and sought outside help. They invited a speaker from Mecosta County, Michigan, where a similar citizens group was fighting a Nestlé Waters plant. They secured financial help from the Haas family of San Francisco, which owns property along McCloud's trout streams. And they approached Donald B. Mooney, a Davis-based sole practitioner, for legal representation.

"Concerned McCloud Citizens contacted the Sierra Club, and the Sierra Club put them in touch with me," says Mooney, who specializes in environmental and public-interest litigation. "It just struck me as an egregious example of an agency--the services district--trying to impose a project on a community without any significant citizen input."

In March 2004 Mooney filed a petition for writ of mandate, challenging the district's approval of the agreement on the ground that it had failed to conduct any environmental review under the California Environmental Quality Act (CEQA) prior to the vote.

As the arguments on both sides deepened and hardened, McCloud split into warring factions. "I've had holes punched through my garage door and my fences torn down," says Dragseth, who maintains a lovingly restored home with her husband, Bill. "This town was one of those places you hear about where nobody locks their doors and everybody liked everybody. It's all changed now. It will never be the same."

Dragseth is deeply resentful of accusations that she and other board members signed away McCloud's greatest asset for a pittance. And she's also upset at claims that Nestlé compromised the board's integrity by paying the legal expenses the board incurred during the contract negotiations, and by reimbursing the agency's general manager for time logged on the project.

"They acted like we rolled over," Dragseth says, referring to the projected annual payments from Nestlé Waters. "But that project would've reinvigorated McCloud. It would've provided about 250 jobs, and brought back the prosperity the timber industry once provided. As it is, we're dying. The population is old and getting older. We have only six kids in the high school, and the people who used to man our volunteer fire department left when the lumber mill closed."

Concerned McCloud Citizens won the first phase of the legal fight. In March 2005 Siskiyou County Superior Court Judge Roger T. Kosel granted the petition for writ of mandate and directed the district to void the original agreement, concluding that it amounted to the creation of an entitlement for Nestlé and improperly committed the district to the project. According to Kosel, "When the agreement creates an option for the purchase of such a vital and environmentally sensitive community resource such as drinking water, with terms potentially extending out to 100 years, and the District is on the verge of divesting itself of any modicum of control over the compliance process, it is an abuse of discretion not to proceed with CEQA compliance prior to approval of the Agreement." (Concerned McCloud Citizens v. McCloud Cmty. Servs. Dist., 147 Cal. App. 4th 181, 188 (2007) quoting from the trial court decision.)

Shortly after Kosel's decision, Nestlé appealed. Concomitant to the court proceedings, Saperstein says, the company began preparing an environmental

impact report to submit to the county. Nestlé released a draft EIR (DEIR) for public comment in July 2006, but Saperstein says that after receiving comments the company elected to conduct further investigations rather than issue a final report.

Nestlé's filing of the DEIR opened the second round in the dispute. Concerned McCloud Citizens had acquired allies, including California Trout and the McCloud Watershed Council. The council commissioned public policy consultancy ECONorthwest to conduct an independent economic analysis of Nestlé's plan. California Trout and Trout Unlimited, meanwhile, brought in Rachel B. Hooper, managing partner of Shute, Mihaly & Weinberger in San Francisco and an authority on CEQA.

Under CEQA, Hooper says, all potential environmental impacts of a project must be described in detail so that appropriate mitigation measures can be determined. But Nestlé's draft EIR barely touched on some of the project's major impacts, she contends. In addition, Hooper describes the DEIR's reference to the contract's nominal cap of 1,600 acre-feet of spring water a year as deceptive. "[The cap] applies only to 'qualified' spring water, and only Nestlé can determine what 'qualified' water is," she says. "The contract then allows the company to take virtually unlimited amounts of 'unqualified' spring water--whatever that is--and unlimited amounts of groundwater that is not included in the 1,600 acre-feet cap."

Hooper hired Philip Williams & Associates, a San Franciscobased environmental hydrology firm, to evaluate Nestlé's DEIR. In an October 2006 report, the consulting firm determined that the report failed to address the project's impacts in virtually every hydrological area, including the quantity and source of the water as well as the effects on local stream flows and aquifers. In addition, hydrologic mitigation was not linked to the agencies with adequate expertise and permitting authority.

"I think the Williams analysis and other comments made it clear to everyone--including Nestlé--that the [draft] EIR wouldn't wash," Hooper says. "It really put their backs to the wall."

In January 2007, however, the court of appeal reversed the trial court, ruling that the district's approval and execution of the agreement was contingent and therefore did not constitute approval of a "project" within the meaning of CEQA. "At the current planning stage of this proposed project, preparation of an EIR would be premature," the court concluded. "Any analysis of potential environmental impacts would be wholly speculative and essentially meaningless." The judgment reversed the lower court's issuance of a writ of mandate and reinstated the original agreement (Concerned McCloud Citizens, 147 Cal. App. 4th at 197).

Still, project opponents were convinced that Nestlé's final EIR wouldn't pass muster. "The appellate court supported the district's approval of the contract subject to subsequent compliance with CEQA," Mooney says. "But the draft EIR that was released in July 2006 was wholly inadequate."

The contract remained at the core of the dispute. Nestlé opponents began talking with Bassak in fall 2007, and his interest--and indignation--increased through the winter. "Mooney and Hooper were doing very good work, but the coalition decided it wanted somebody on the team who specialized in commercial litigation and contract law," Bassak says. "Our job [at Manatt] was to review the agreement and see if we could convince Nestlé to cancel it, or find another way to invalidate the services contract."

By 2007, events seemed to be conspiring against the Nestlé plant. Opponents had created a new organization, the Protect Our Waters Coalition, composed of the McCloud Watershed Council, California Trout, and Trout Unlimited. They built alliances with national groups such as Food and Water Watch, a nonprofit consumer rights organization in Washington, D.C. And stories in the mainstream press about the environmental impacts of bottled water in general were beginning to gain traction.

"There are real cultural pressures on bottled water," says Donna Boyd, a consultant for California Trout. "The population that was the target for this product--educated people concerned about health and the environment--is now moving away from it." She adds, "[McCloud] has received international media attention. It's not just about the town anymore. This fight has defined the national dialogue on bottled water."

Last December, U.S. Rep. Dennis Kucinich (D-Ohio) convened the first-ever congressional hearings on the environmental risks of the bottled-water industry's extraction of groundwater. At the hearings, the McCloud opponents of Nestlé Waters joined forces with their counterparts in Maine, site of the company's Poland Spring plant. "That hearing didn't go Nestlé's way," Boyd recalls. "You had Heidi Paul [Nestlé's vice president of corporate affairs] going up against locals from McCloud and Poland Spring. It really beat up Nestlé's image."

As much as anything, Nestlé Waters's timing on the project was bad. Just as public sentiment against bottled water was rising, Northern California got clobbered by drought and then international oil prices spiked, boosting diesel-fuel prices to \$5 a gallon and drastically increasing Nestlé's distribution costs. For the first time, the company blinked.

Last May, Nestlé Waters announced that it would scale back the proposed McCloud plant by 60 percent. It also agreed to produce a new EIR, baseline data for which could take two years to establish. David Palais, Nestlé's project

manager for Northern California and the Pacific Northwest, says the revised project reflects the changing realities of the business. "Since we started negotiations five years ago, we've built a bottling plant in Denver and expanded our operations at other western sites," he says. "We no longer need a plant at McCloud of the size we first proposed."

Hooper at Shute Mihaly wasn't impressed by the downsizing. "We have a new proposal," she responded, "but we don't have a new contract. And it's all about the contract."

In late July, Nestlé Waters received more bad news. The California attorney general's office sent a letter to the Siskiyou County Planning Department expressing its opinion that "the environmental review for the previously proposed project had serious deficiencies." Deputy Attorney General Deborah R. Slon then dissected the DEIR "with the hope that our comments on the deficiencies of that document will provide some guidance to Nestlé and the County in revising the project and the EIR." She highlighted problems associated with plastic bottle production, truck traffic, and diesel-engine exhaust, as well as unknown impacts on local watersheds and wildlife and--in particular--global warming.

Saperstein says he was disappointed that Slon had relied on outdated information. "If they had let us know what they were doing, she would have learned that Nestlé did not intend to rely on the draft EIR, and instead was planning to conduct further investigations on stream flows and renegotiate the contract," he says. "But they didn't even give us a call."

Saperstein adds that the AG's letter doesn't necessarily indicate that the office opposes the bottling plant. Rather, he says, Slon's apparent emphasis on global warming effects points to the office's larger agenda. "Everyone is waiting for the state Air Resources Board to define goals under AB 32 [the California Global Warming Solutions Act, Cal. Health & Saf. Code, §§ 3850038599]," Saperstein says. "Those goals will set limits on greenhouse-gas emissions for virtually every industry in the state. Clearly, the AG is putting everyone on notice that while we wait for specifics, carbon footprint analysis must be part of any environmental review."

Hooper regards Saperstein's position as spin. "The attorney general's letter was a complete confirmation of our position," she says. "The AG called Nestlé's EIR 'fundamentally and basically inadequate.' "

In early August, opponents of the original agreement achieved something many had considered impossible: Nestlé Waters announced that it had elected to opt out of the contract, which it was permitted to do without penalty prior to October 2008. The company stated it would begin negotiations with McCloud for a new contract based on its scaled-down proposal for the plant. The community

services district vowed to conduct public hearings, and generally to bargain with Nestlé Waters in an open fashion.

Rachel Hooper says Nestlé's announcement was tremendously gratifying. But she emphasizes that the district's approval of any new contract for the sale of water must be preceded by a comprehensive, thoroughly vetted, and formally adopted EIR. "CEQA is clear on this," she says.

That's not how Saperstein sees it, however, and this difference of opinion could lead everyone back into the legal thickets. "The appellate court's decision indicates that a binding contract can precede an EIR," he says, "though obviously an EIR must be in place before ground can be broken on any project."

Legally, there are other issues besides CEQA. The McCloud Watershed Council is now evaluating the status of a newly discovered snail at one of the springs to determine whether it could be the basis for litigation under the National Environmental Policy Act (42 U.S.C. §§ 43214370f) or the Endangered Species Act (16 U.S.C. §§ 15311544). Project critics also point out that water pipelines would have to cross property administered by the U.S. Forest Service. That agency must approve all easements, and it has given its imprimatur to Nestlé for the proposed project. But a body of case law requires the Forest Service to evaluate easements for environmental impacts and determine if they are "reasonable" before they're approved.

"It's not just the snail," Hooper says. "There are 15 species of concern on Forest Service lands that the pipeline will cross, including spotted owls. The Forest Service also has to look at all other potential impacts--noise, traffic congestion, air pollution from the plant and trucks, the impact of water reduction to federal lands, everything."

With the old contract now cancelled, the ball for negotiating with Nestlé is back in the McCloud Community Services District's court. Critics of the project aren't happy about that--memories of the earlier closed-door negotiations continue to gall them, though it seems there's little they can do. As Saperstein points out, the district "has clear rights to the water from the springs under a license from the State Water Resources Control Board," adding, "The district is sanctioned to allot the town's water for all appropriate uses--residences, schools, commercial facilities."

Tim Dickinson, president of the district board, says there have been unofficial communications between Nestlé manager Palais and individual board members about how to restart the company's relationship with McCloud. He points out that only one member who approved the original contract remains on the board. And as far as Dickinson is concerned, Nestlé's cancellation of the agreement came as a relief.

"The old contract was concluded quickly, with very little public input," he acknowledges. "That's not going to happen this time around. Maybe now we can start bringing people back together as we investigate the possibilities. It's an opportunity for building some bridges."

A sizable number of McCloud's residents still remember the town as it used to be, and they would like to see it prosper again. The Nestlé project, they say, is their best chance for that to happen.

"People are fooling themselves if they think we can make it without some kind of solid economic base," says Chuck Jordan, a former logger and mill worker who volunteers as a docent at the local museum. Jordan is soft-spoken and courtly as he answers questions from visitors musing over the old photographs, antique chain saws, and arcane agricultural implements on display from McCloud's glory days.

"If you want a working community, you need to have working people," Jordan says. "Timber built this town. We don't have that base anymore, but we do have the water. We should use it. Tourism alone can't support us."

Ultimately, McCloud's fate may hinge more on oil than on water, making all the current legal issues and civil disputes moot. Water is heavy, observes Boyd of California Trout, and it takes a lot of trucks burning pricey diesel fuel to move it.

Nestlé's Palais doesn't dispute that assessment. "Our primary market for the Arrowhead Water brand was Southern California," he says. "There are significant fuel costs to moving [the] product from McCloud to the south state. We need high-quality sources, but like any good company we also have to control costs so we can maintain value. The price of diesel was certainly a consideration in our decision [to downsize the project]."

To Nestlé's allies, such talk sounds as if the company may be having second thoughts about coming to McCloud at all. Dragseth considers Nestlé to be the town's last great hope, and now she believes it's gone a-glimmering.

"I hear people say that bottled water is going away, but I don't believe it," Dragseth says. "There'll always be some demand, especially for water as pure as ours. For me, the project was always about what's good for our town. This was a deal that would've worked for McCloud. It would've revived us. Now, the whole thing just makes me want to cry."

To the Nestlé project's critics, this conflict has been necessary--even salutary--and could still lead to the town's salvation. The fight, they say, was never about whether McCloud's nonpareil spring water should be bottled. It's more a matter of how much should be taken, and who should reap the benefits.

Richard McFarland, a local businessman who runs a flooring and paneling company, says McCloud's prosperity will be found in a diversified economy. "We're not against bottling spring water, but we do think the town should derive the lion's share of the profits," he says. "And we don't think we should do it at the expense of our rivers and fisheries. There's a right way and a wrong way to bottling and selling water. Nestlé's was the wrong way."

Dickinson says a diversified economy would be good for McCloud. The district has established an area planning committee to look at the "preferred growth process" for the community. And residents, he says, seem to be making a concerted effort to move beyond the bottling plant dispute. "It's not that they've reconciled," he says. "But at least they're trying to [avoid] the subject. That's a start."

For Bassak, certain things trump economic development. "The most important reason I got into this case was my nine-year-old son," he says. "He's old enough now to begin fly-fishing. I want to share the peace and beauty of the McCloud River with him, and show him that some things are more important than money. I'm doing this for him."

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