THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Date:	April 19, 2012
To:	Board of Directors Member Agency Managers
From:	Jeffrey Kightlinger, General Manager Marcia Scully, General Counsel
Subject:	Responses to Assertions of San Diego County Water Authority ("SDCWA") in March 28, 2012 Letter to General Manager Kightlinger

The SDCWA General Manager recently sent a letter in response to a letter Metropolitan sent to the San Diego Union-Tribune. While we do not intend to engage in an exchange of letters, so many of the statements in the SDCWA letter were false and the judicial decisions so grossly mischaracterized that we felt it important to correct the record. Below are responses to specific assertions in Maureen Stapleton's March 28th letter.

1. **SDCWA STATEMENT:** With respect to its wheeling rate challenge, "the Water Authority prevailed in its prior lawsuit."

RESPONSE: This is revisionist history and completely false. Furthermore, it is an attempt to justify the enormous legal fees spent on suing Metropolitan over the years, fees that have produced absolutely nothing. While SDCWA prevailed at the trial court, the Court of Appeal ***unanimously*** reversed that decision, finding in favor of Metropolitan. SDCWA petitioned the California Supreme Court to review the decision but the petition was not accepted and the Appellate Court's ruling is settled law. See MWD v. Imperial Irrigation District, et al. (2000), 80 Cal. App. 4th 1803. In a unanimous decision, the Court of Appeal held that Metropolitan had properly followed the law in establishing its wheeling rate. In particular, the court held that Metropolitan (i) is entitled to recover its system-wide costs, and is not limited to charging only for incremental costs caused by the wheeling transaction as SDCWA claimed; (ii) may base its charges on a "postage stamp" basis, rather than limiting the charges to only that part of Metropolitan's system used in the transaction as claimed by SDCWA; and (iii) is not prohibited from setting a fixed wheeling rate applicable to all wheeling transactions recovering those system-wide costs through its rate-making process as SDCWA claimed.

2. **SDCWA STATEMENT**: With respect to its preferential rights challenge, "the SDCWA received from the court the legal clarification it needed."

RESPONSE: Apparently, court losses are a "legal clarification" for SDCWA which somehow justifies millions of dollars in fees. At the trial court level, SDCWA's challenge was summarily dismissed without leave to amend. The First District Court of Appeal upheld dismissal of SDCWA's complaint, and held the following in SDCWA v. MWD (2004), 117 Cal. App. 4th 14:

"San Diego argues that since a significant portion of Metropolitan's water sales revenue goes toward capital costs and operating expenses, section 135 [of the MWD Act] should include that portion of water sales revenue

in the calculation of its members' preferential rights. In the published portion of this opinion, we conclude that Metropolitan has properly interpreted section 135. In the unpublished portion, we reject San Diego's alternative claims, including that Metropolitan's interpretation violates the California Constitution."

SDCWA unsuccessfully petitioned the California Supreme Court to review the Appellate Court decision. If this result is satisfactory to SDCWA, we look forward to further "legal clarification" in the current suit.

3. **SDCWA STATEMENT:** "[T]he Water Authority's allegations of procedural misconduct and discrimination have not been 'dismissed' and remain pending before the court."

RESPONSE: SDCWA filed its first amended complaint on October 27, 2011, introducing a cause of action for breach of fiduciary duty. Of the eight causes of action, only the fiduciary duty cause of action referred to a cabal, secret meetings, and an anti-San Diego coalition. On January 6, 2012 the Superior Court dismissed, ***without leave to amend***, the breach of fiduciary duty cause of action. While SDCWA is attempting to resurrect the allegations underlying the dismissed cause of action involving alleged Metropolitan and Member Agency misconduct in a second amended complaint, it cannot re-file allegations that are invalid and irrelevant.

4. **SDCWA STATEMENT:** The allegation that SDCWA's lawsuit is motivated by the cost of its IID water transfer is inaccurate and does not address the "real issue in the litigation."

RESPONSE: The rate that SDCWA pays Metropolitan to receive the water it purchases from IID is the component of the Metropolitan rate structure that SDCWA is directly challenging in the litigation. In both its pleadings and its comments before the Metropolitan Board, SDCWA has referenced the conveyance rate – which was set by the parties in a negotiated agreement – as the basis for the alleged "overcharges" and discriminatory treatment of SDCWA. Thus, based upon SDCWA's own statements the costs related to the SDCWA-IID transfer are a primary driver for SDCWA's allegations both in the litigation and in various public forums.

SDCWA has known ***from the beginning of its water transfer agreement*** with IID that it would be required to pay both the cost of the water and the applicable Metropolitan rate for conveyance and SDCWA signed agreements to that effect with IID and Metropolitan. To date, only eight years into a very lengthy transfer agreement, SDCWA has paid over $200,000,000 more for its IID transfer water than it would have paid for the same water from Metropolitan. SDCWA was advised well in advance that the deal it intended to strike with the IID would be far more expensive than Metropolitan water. SDCWA chose to go ahead, telling its ratepayers that "added water reliability" was worth this extraordinary investment. The fact that its deal with IID turned out to be more expensive from the beginning and has gone up significantly faster than inflation over the past eight years is a circumstance of SDCWA's own making in its quest for water independence.

5. **SDCWA STATEMENT:** The characterization of "MWD admissions" as a "joke" is not credible.

RESPONSE: As pointed out in the Kightlinger Letter, there are a sum total of two emails in the 500-plus pages of documents that SDCWA released, both sent by the same Beverly Hills staffer to another staffer at Beverly Hills that contain the phrase "Secret Society."

As an initial matter, an email from one staffer at the City of Beverly Hills is not an "MWD admission." Second, the emails were clearly sent in jest and the author of the emails has stated that he was jokingly referring to SDCWA's earlier letter about a "Secret Society". In the documents SDCWA has cited from among the 500-plus pages that SDCWA released and the 60,000 pages it has purportedly received, there is no indication that anyone other than this one staffer has used the phrase "Secret Society." Plus, SDCWA has stated that it has agendas and meeting notes from many member agency working group meetings, and yet it has not pointed to the use of the phrase "Secret Society" in any of these documents. This refutes the suggestion that "Secret Society" was a "moniker" used by member agency staffers as SDCWA has stated.

SDCWA sent a letter to Metropolitan's Board complaining about this member agency group a month before these two emails were even sent. The member agency managers sent an open letter to the full Board describing the purpose of the member agency working group in November of 2011. SDCWA also filed its proposed first amended complaint – alleging a cabal and secret meetings – one month before the two emails were sent. These open letters were sent, and the complaint distributed, months before SDCWA dramatically made its "Secret Society" claims at the March 2012 rate hearing.

6. **SDCWA STATEMENT:** "Your characterization of the practice of conspiring to set board policy behind closed doors, excluding San Diego, as business as usual—is an indictment of MWD, not a defense."

RESPONSE: This is the kind of political characterization so sadly common in political campaigns but shocking coming from a public agency. The Kightlinger letter discusses the process by which Metropolitan and member agency ***staffs*** develop policy ***recommendations***, and explains why this process is legal under the Brown Act ***and standard for all public agencies, including SDCWA***. Nothing in any document that Metropolitan has reviewed or SDCWA has produced suggests that a quorum of Directors acted "behind closed doors" or that any Metropolitan or member agency staff "set policy." Metropolitan staff, sometimes in consultation with member agency representatives, makes policy recommendations to the Board, and the Board makes policy decisions, and SDCWA is fully aware of this process. Member agency staff, other stakeholders, and constituents are free to meet with who they wish, discuss issues, and even strenuously advocate positions. This is the democratic process.

7. **SDCWA STATEMENT:** "MWD's delay tactics in the litigation contradict your claim that the trial of this matter should take place as quickly as possible."

RESPONSE: This assertion is similarly erroneous. Metropolitan is not employing "delay tactics." Rather, by seeking to adjudicate the rate challenge first, as the law provides, the central part of the case could be rapidly concluded based on the administrative record. It is SDCWA's attempt to chase a conspiracy theory that is delaying a resolution of the rate challenge and is driving up the legal fees for all ratepayers.

8. **SDCWA STATEMENT:** It is inappropriate for Metropolitan to "employ the same financial consultant that worked for more than two years with the majority group of Metropolitan member agencies to advise Metropolitan on the same issues."

RESPONSE: SDCWA seeks to allege impropriety and conflict where none exists. There is nothing atypical or inappropriate about the contractual arrangements to which this assertion pertains. Financial consultants are not

attorneys and member agencies are not "adverse parties" to Metropolitan in discussions of financial and rate policies. Furthermore, Metropolitan employed Malcolm Pirnie's parent company ARCADIS, not "the same financial consultant" used by the member agency working group; ARCADIS was hired to provide technical assistance to the Metropolitan Long-Range Finance Planning Group (in which SDCWA participates), which is not dealing with the "same issues" as the member agency working group; and we understand SDCWA has itself on occasion hired Malcolm Pirnie, notwithstanding its work with the alleged "Secret Society."

These responses to SDCWA's erroneous assertions and mischaracterizations are provided to ensure the dissemination of accurate information and correct the record.